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COMPETITION POLICY AND SMALL FIRMS

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POLICY

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CHAPTER 1

INTRODUCTION

The Canadian government has shown increasing concern in recent years for the small business sector of the economy. In 1976, a Minister of State For Small Businesses and Tourism was appointed, and this position is now supported by a Small Business Secretariat in the Department of Regional and Industrial Expansion. Government programs and policies aimed specifically at small business include the Small Businesses Loans Program, Small Business Bond Program, special R&D incentives for small business, special tax measures, financing through the Federal Business Development Bank, and provisions of the Enterprise Development Program and the Technical Information Service of the National Research Council. In addition, directives have been issued by Supply and Services Canada to recognise the presence of small business in government procurement practices. Other government policies such as R&D incentives are industry wide, and affect small business as part of the business sector, but do not focus specifically on small business.

The prevailing view that provides support for the desirability of having a flourishing small firm sector is based primarily on evidence collected in the U.K. and U.S., with support from studies undertaken in Canada, Western Europe, Japan and Australia. Although the economic evidence is not conclusive, it has provided additional support for political and social views that society is better off with a strong small firm sector. Political considerations have related to the desire for measures to reduce the concentration of power in society, and social considerations have

stressed the opportunities and way of life which is offered by small firm ownership.

The starting point for this study is government's decision to support the small firm sector. The purpose of this paper is to examine the range of issues which relate to competition policy in order to determine how this policy area affects small firms, and whether the problems faced by small firms can be addressed through competition policy.

The study will identify the major problems faced by small businesses in Canada that can place them at a competitive disadvantage, examine ways in which competition policy can assist in dealing with these difficulties, and based on this information specify areas for future research on small business that hold the promise of a pay-off from the standpoint of competition policy. This examination will be based on existing literature, reports and selected interviews.

There is a considerable volume of literature on the nature and problems of small firms in industrialised countries, some of which deals with the general focus of this study, namely competition policy and small firms. At the outset it is useful to consider two dimensions, first horizontal competition and second, vertical competition between large and small firms. In the first instance, the firms compete against each other in the same product market, while in the second, the firms are in a buyer-seller relationship, where the small firm acts as a supplier to or a customer of a larger firm. In both cases, competition can involve price and non-price dimensions, and the relative competitive strength of the different size firms will depend on factors affecting the cost and bargaining

positions of the firms, as well as government policies.

Oligopolistic industries are frequently populated by a few large firms and a fringe of smaller firms. When the presence of the large firms is due to economies of scale at the plant or firm (multiplant) level, the parallel existence of competing smaller firms is usually explained in terms of (a) the regional nature of markets, (b) product differentiation which allows small firms to exist in a corner of the market, (c) innovation which gives the smaller firm an advantage, (d) the ability of small firms to provide effective local service, (e) rapid market growth which allows new small firm entry, (f) absence of competition to drive out small firms, perhaps deliberate in order to show the presence of competitors to antitrust authorities, and effected through umbrella pricing, (g) unimportance of economies of scale so that a range of firms' sizes are efficient, and (h) government subsidies to industry.

An understanding of the reason for the persistence of small firms alongside large firms will help to explain the competitive situation for the small firms. For example, if umbrella pricing is the reason, the small firm's existence rests on the pricing policy of the large firms: if innovation is the reason, the small firm's advantage depends on the speed with which the innovation can be copied by the larger firms: if regional markets (geographical segmentation) is the reason, then factors affecting transportation costs will determine the competitive situation of the small firm. This is particularly

the case where the small firm has a single product while the larger firm has a diversified product range. In the single product case, the livelihood of the smaller firm tends to be much more uncertain, and thus subject to disciplinary actions by larger firms in the event that the smaller firms cut prices, which has hurt or has the potential for hurting the larger firms. Typically, the larger firms have a more diversified product range and sell in a larger geographic market which reduces their vulnerability (Averitt, 1968, p. 2).

Horizontal competition between large and small firms presents a different range of issues where the large firm is vertically integrated through several stages of production, e.g., mining, refining and fabrication, and the small firm is confined to one stage only, e.g., refining, and competes horizontally at one stage only. In this case, the position of the small firm depends on market conditions at all three stages. If the small firm refinery can purchase its inputs from the mining stage, and sell its outputs to the fabricating stage in competitive markets, its vulnerability is much less than if it has to purchase inputs from the large integrated producer's mining stage, and/or sell its output to the large integrated producer's fabricating stage. The latter situation is one where the smaller firm's survival is more dependent on the larger firm.

A clear case of vertical competition exists when a small firm acts as a supplier to or a customer of a large firm. Small

firms in this situation have been described as satellites of large firms, and really represent, for the large firm, an alternative to integrating backwards or forwards. Where a small firm has a long term contract for the supply or output of a large firm, the difference between the small firm as an independent entity and as a division of a large firm becomes marginal, since the small firm is being used as a captive supplier.

The reasons why a large firm would use a small firm as a supplier or customer include (a) to transfer risk, (b) to increase the flexibility of operations especially where fixed costs are significant and there is need to adjust to changes in capacity utilization (i.e., a large firm may provide some of its own inputs and buy the remaining requirements), (c) to reduce the outlay of capital, (d) to avoid employee fringe benefit problems, and (e) to avoid attention from antitrust authorities. While some of these reasons imply disadvantages for the small firm suppliers, it is also clear that the large firm will be dependent on the small firm in different degrees. However, the competitive vulnerability of the small firm is almost always greater, especially if it is a single product firm and has few alternative customers or suppliers other than the large firm. Market foreclosure then becomes a real threat if the large firm refuses to buy from or supply the small firm.

Averitt draws a distinction between floating and attached satellites according to whether the small firm has alternative

options to its relationship with the large firm (Averitt, 1968, pp. 63-66). Another competitive strength of the larger firm is that it can integrate, or it can threaten to integrate, backwards or forwards into the industry in which the small firm resides. This tactic was used by the chain grocery stores to counteract legislation which favoured the operations of small firms in the United States.

Various kinds of competitive conduct are often experienced in situations involving large and small firms, e.g., resale price maintenance, price discrimination, exclusive dealing, requirements contracts, full line forcing, tied sales, exclusive franchising and, reciprocal dealing. The foregoing examples of conduct are ones which are not unique to large firm - small firm transactions but frequently do occur. The economic consequences for competition vary depending on other aspects of the market, but in general can involve some aspect of market foreclosure. The consequences also have a political dimension.

> Any discussion of equity moves rapidly from an economic to what is essentially a political view, since equity is ultimately a value problem whose social resolution is of the essence of politics...This is the problem of the relation between the large enterprise and the host of small satellite enterprises which become its dependents. These may be customers bound to it by a variety of contractual relations, such as the service stations bound to the major oil companies who are their suppliers (and frequently their landlords and bankers as well), or the automobile dealers connected with the manufacturers by franchise arrangements. Or they may be customers without explicit contractual ties, yet nonetheless dependent on the maintenance of "customary" relations with large suppliers of their essential raw

> material, as has been the case with small fabricators of aluminum and steel products, whose business destinies have been controlled by the informal rationing schemes of the primary producers in the frequent shortage periods of the postwar decade. Or they may be small suppliers of large firms: canners packing for the private brands of the large chain grocers, furniture or clothing manufacturers producing for the chain department stores and mailorder houses, subcontractors producing for the major military suppliers. In any case, these small firms are typically wholly dependent on their larger partners (Kaysen, 1960, p. 97).

In sum, the competitive position of a small firm in a horizontal or vertical relationship to a larger firm can be one of dependency and vulnerability. Obviously, there are exceptions, as in the case of the small firm which is a regional monopoly protected by high transportation costs, or where the firm has some characteristics which are difficult to duplicate. However, the general tendency of dependency and vulnerability is reinforced according to some writers by certain characteristics internal to and often found in the management of small firms (Averitt, 1968; Broadridge, 1960; Galbraith, 1973; Herendeen, 1975; Lindbeck, 1974; Davis and Kelly, 1972; Thompson, 1973).

METHODOLOGY AND SOURCES

This study is based on existing theoretical and empirical literature on industrial organization and small firms. The approach is to examine the issues at two levels, first the nature of competition between firms, and second the internal characteristics of small firms related to factors such as financing, marketing,

management and entrepreneurship. The contention is that competition policy can only assist in alleviating the problems, if there is an understanding of both the relationship between firms and the internal characteristics of the firms. Included in this examination will be a discussion of the relationship of small firms to government.

The research draws on theoretical literature and on empirical literature in Canada and in other countries. In Canada, material is available in government from the Small Business Secretariat of the Department of Industry, Trade and Commerce, the files and reports of the Department of Consumer and Corporate Affairs, Statistics Canada, Royal Commission reports and court cases. In the private sector, information is available in briefs and reports of associations such as the Canadian Federation of Independent Business, the Ontario Federation of Agriculture, as well as other industry and trade associations. Selected interviews have also been undertaken in order to elaborate on the existing materials.

Chapter 2 describes the small firm sector in Canada. The efficiency aspects of small firms, regarding technical, allocative, internal, dynamic and transaction cost efficiency are discussed in Chapter 3. A survey of the problems faced by small firms is set out in Chapter 4. Chapter 5 contains an examination of the role of small firms in the development of competition policy in Canada, and Chapter 6 contains an overall summary.

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CHAPTER 2

THE SMALL FIRM SECTOR

2.1 CONCEPT OF A FIRM

Although economists have difficulty in defining what a firm is, some organization called a firm exists and business gets done. The business decision-maker fortunately is not constrained by the theoretical difficulty. Penrose suggests that the problem arises in part because the appropriate definition of a firm will vary with the problem being addressed. In the traditional economic 'theory of the firm' the organization is portrayed as a decision-making "production function to which a profit maximization objective has been ascribed" (Williamson, 1981a, p. 1539); this firm acquires inputs, combines them and converts them into outputs which are then sold. This portrayal of the firm is used to explain how prices and the allocation of resources among different uses are determined, and is part of a wider theory of value (Penrose, 1963, p. 11). In developing a theory of the growth of the firm, Penrose provides the organization with other attributes which are relevant to examining growth considerations.[1]

This lifeless and rather uninteresting characterisation of the firm ignores its internal, especially its organizational and

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[1] Penrose's attributes are described as follows: "It is the 'area of coordination' - the area of 'authoritative communication' - which must define the boundaries of the firm for our purposes, and, consequently, it is a firm's ability to maintain sufficient administrative co-ordination to satisfy the definition of an industrial firm which sets the limit to its size as an industrial firm" (Penrose, 1963, p. 20).

hierarchical features. A similar approach ignoring internal firm characteristics seems to reappear in some of the applied economic literature in industrial organization. For example, Scherer continues to state in the second edition of his widely used textbook that industrial organization "...has little or nothing to say about how one organizes and directs a particular industrial enterprise" (Scherer, 1980, p. 1).[1] It is true that industrial organization does not study many business management topics, but it does examine topics such as vertical integration, diversification, mergers, and a wide range of distribution arrangements such as exclusive dealing, franchising, requirements contracts, tying agreements, and consignment selling, all of which are relevant to 'how one organizes and directs a particular industrial enterprise', and all of which are discussed in Scherer's text. More recently, the work of Porter and Caves tended to merge the study of management with that of industrial organization (Porter, 1980; Caves, 1980).

The concept of a firm tends to vary between writers and this creates problems for the discussion of 'small firms', which implies that the size of the organization can be measured. In one sense a firm is smaller because it engages in less economic activity, but the boundary of a firm is sometimes difficult to distinguish. For example, one car manufacturer may sell its cars to independent

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[1] J.S. Bain makes a similar point that the treatment of internal management performance is left to the literature on management organization (Bain, 1968, p. 2).

distributors, another may undertake both the manufacturing and distribution itself, while a third may negotiate a franchise agreement and requirements contract with a distributor. Other things being equal, the first manufacturer (firm) will be smaller than the second. The third one raises the problem as to where to draw the boundary of the firm: the separation of manufacturer and distributor is not as distinct as in the first case, nor is their combination as complete as in the second.

The statistician approaches the concept of a firm in a manner which allows units to be counted and various measurements to be made, such as sales, employment, value added and assets. Statistics are collected about establishments (plants), enterprises and concerns, all of which are units which are relatively easy to count and measure, but which may not correspond, especially in the case of an establishment, to an independent decision-making unit or firm. Data are also collected about corporations, which are defined for legal purposes, and which conveniently report annually for taxation purposes. However, joint-ownership of corporations may mean that two or more corporations constitute a firm with one decision-maker.[1] The decision-making scope of the organization tends to be of prime concern for economic analysis.

The foregoing discussion suggests that the concept of a firm is elusive, so that the measurement of firm size is difficult,

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[1] Statistics Canada publications use these different concepts, e.g., Manufacturing Industries of Canada, Cat. No. 31-210; Industrial Organization and Concentration in the Manufacturing, Mining and Logging Industries, Cat. No. 31-514; and Corporation Taxation Statistics, Cat. No. 61-208.

and what one writer may refer to as the small firm sector may differ from another writer. Nailing down the meaning of the concept must precede the decision as to which measure of size to use, for example, sales, assets, value-added or employment.

The definitional problem is not a barrier to further discussion, because obviously businessmen make decisions about production within the context of organizational units they call firms, and because policy makers deal with these units. It is, however, important to be aware of the problem in order to understand the attributes of a firm which are relevant to a particular topic of discussion.

2.2 THE PROBLEM OF DEFINITION

Small enterprises represent a large and diverse group, ranging from "little" businesses, such as independent contractors and family-owned retail establishments, to wholesalers and manufacturers of sophisticated computer hardware. Both quantitative and qualitative approaches have been adopted towards the problem of defining small relative to medium and large-scale businesses. Any definition implies a purpose whether for statistical collection requirements, behavioral analysis or the formulation of public policy.

2.2.1 Use of Quantitative Criteria

Quantitative criteria frequently used to define firm size for statistical purposes include number of employees, assets, value-added and sales. Each measures a different aspect of size which may be useful depending on the issue being examined.[1] In general, an employment measure will provide an upward bias to the size of labour intensive firms, while an asset measure will have a similar effect on capital intensive firms. All but employment uses a monetary unit of measurement, whereby size is dependent on price changes as well

[1] Caves (1977) notes "It is not clear what dimension of company size holds the greatest interest for public policy - total assets, sales, employees, or something else" (p. 179). Other discussions of firm size are found in Adelman, (1958), pp. 8-9 and McFetridge, (1977), p. 27.

as real changes. The use of sales to measure size ignores differences in the degree of vertical integration which is caught by using a measure of value-added.

While statistical ranking by employees or sales volume provides a general overview of the percentage of total employment or economic activity accounted for by small businesses, the use of class intervals to differentiate between small, medium and large-sized firms is essentiallly an arbitrary decision. Borderlines are necessarily imprecise, and rule-of-thumb standards, such as the definition of small firms as those employing less than 500 employees, ignore differences between industry sectors, the existence of geographic submarkets, and differences in market structure.

According to the above approach, an independent oil refinery with 1,000 employees is medium-sized or large. An alternative approach is to measure firm size relative to firms in the same industry. By this definition, the refinery might be small. Using a relative measure, it is possible for a firm to be large provincially, medium-sized nationally, and small in the international markets in which it competes. Relative size also has important behavioral implications for firms in oligopolistic industries.

2.2.2 Use of Qualitative Criteria

Quantitative factors condition market behavior and organizational structure to a large extent, but in many respects,

aside from sectoral and market-related definitional problems, they are unsatisfactory to delineate the essential qualities and problems which distinguish small from large firms. According to one writer, whereas

> the big or giant business exists by virtue of its institutionalized skills and financial and market power, the small business exists by virtue of its personalized skills and market adaptability (Hollander, 1967, p. 5).

Lack of real power to control its environment, both with respect to the price of inputs and outputs is one of the essential distinguishing characteristics of the small firm. This is a direct result of small market share. On the other hand, the economic performance of small firms is dependent upon an ability to satisfy demand often in direct competition with larger firms. In this regard, small businesses can be an important source of product and service innovations.

Another essential quality of small firms is legal and financial independence. The former precludes as small firms the subsidiaries of large firms. The latter entails that small businesses are effectively controlled by their owner-managers who actively participate in all aspects of the management of the business. The size of small firms permits a personalized management style which involves the functional division of responsibilities, and hierarchical distribution of power, but permits centralization of decision-making, shorter spans of control, and quicker response than the institutionalized management structures of large corporations.

At the same time, financial independence frequently implies special problems with respect to working and investment capital. Inability or unwillingness to raise funds on the capital market often necessitates borrowing from financial institutions at high interest rates. In effect, the expansion and/or freedom of many small firms may be affected by the policies of financial institutions.

Although qualitative criteria lack the convenience and objectivity of quantitative criteria, they are important for the formulation of effective programs designed to assist small businessmen.

2.2.3 Government Definitions

A number of countries differentiate between small and larger firms for the purposes of statistics, taxation or determination of eligibility for government programs designed to stimulate small business development. Most countries, including those with special policies, employ quantitative criteria. Some incorporate qualitative criteria (see Appendix A). The main thrust of all these programs, however, is to provide assistance to small firms for problems related to their size. Behind this is recognition of the importance of the small business sector to entrepreneurial development, economic growth and as a source of employment.

In 1980, the Ministry of State for Economic Development published a Description of Federal Economic Development Policies which attempted to provide a review of government policies in the economic development field, including "small business policy". The small business policy field was defined to include "measures to promote the development of small business activity in Canada through financial incentives, direct assistance and a favourable policy environment." The Minister defined small business largely as firms employing fewer than 100 workers in the manufacturing sector, and firms employing fewer than 50 workers in other sectors. It viewed the small firm as being independently owned, and one which has not developed the managerial structure typical of large, mature corporations.

Although Canada has numerous programs, both at the federal and provincial level, aimed at assisting small businesses, various quantitative criteria are used for determination of eligibility. (Appendix A lists a few examples which help to illustrate the problems associated with establishing a working definition of what constitutes a "small business" in Canada.)

Summary Characteristics

What constitutes a small business obviously involves a degree of subjective judgement. The criteria employed is both varied and often hard to standardize, such as assets, sales, income, number of employees, type of ownership or management structure. Different governments use different definitions to define small business, according to the purpose at hand. Common to all, is the use of summary measurements. Many, however, employ standards which differ with industry sector.

The criteria of financial and operational independence and importance of relative market share are also gaining acceptance, especially in the United States. As noted in Appendix A, the definition of small business contained in the Small Business Act reads as follows: "one which is independently owned and operated and not dominant in its field of operations". The Canadian Federation of Independent Business uses almost the identical words to define small business for its purpose (Kao, 1981, p. 7).

The characteristic of "market dominance" is critical in any discussion of small business in Canada. The limited size of the domestic market and the relative openness of the economy produces situations where some Canadian firms deemed to be dominant in their field in Canada, are viewed as relatively small in an international industry context when measured in terms of sales, assets and employees. In a study dealing with the administration and enforcement of Competition Policy in Canada, enterprises were defined as small if they were not listed on the Canadian Business top 400 (Gorecki, 1979, pp. 217-18). For some industry sectors, this classification may be a reasonable one; however, for the present study the profile of small business in Canada will more likely exhibit the quantitative and qualitative summary characteristics developed by Kao (1981, p. 7).

- The business, as a rule, is managed by the owner or owners of the company. The management team of the business might consist of family members, relatives, and close friends.
- The responsibility for decision-making normally lies with one key executive, with very little or no delegation of authority.
- There appears to be a closer management-employee relationship.
- Small business is the extension of the personality of the entrepreneur.
- Generally, there are fewer (or sometimes no) functional specialists, such as a full-time accountant or a personnel manager, in the organization.
- The company employs fewer than 200 people, and normally has no more than two tiers of management reporting.

- The company's annual sales are less than $2 million.
- In most cases, owner-managers are verbal communicators.
- The company often places little emphasis on long-term planning, although the owner-manager may be aware that a formal, long-term plan is necessary.
- Normally, the company's stock is not listed with the Stock Exchange.
- Doctors, dentists, and lawyers may fit all or some of the above characteristics, but in most cases, they are considered professionals rather than small business operators.

Sales of less than $2 million is consistent with the definition used by the Small Business Secretariat in Canada.

2.3 STATISTICS ON SMALL FIRMS

The Small Business Secretariat (SBS) of the Department of Industry, Trade and Commerce and Regional Economic Expansion has assembled statistics on small business based primarily on the income tax returns of corporations and individuals. The latter group includes both sole proprietorships and partnerships. In the case of individuals, information is extracted from the 'business income' component of the personal tax return: this represents income earned from the conduct of some business activity against which expenses can be charged. Business income can be either one component of an individual's income along with income from employment and from investments, or the sole income of the individual (Small Business Secretariat, 1979)

The use of corporate tax returns means that if a large company does not file a consolidated return, but a return for

each of its incorporated subsidiaries then these subsidiaries may be counted as small firms if they meet the size criteria. The SBS shows a firm to be small if it has sales of less than $2 million, medium size with sales of $2 million to $20 million, and large with sales in excess of $20 million. It was found that a business having approximately $2 million in sales employs about: 75 employees in the manufacturing sector; 50 employees in the transportation sector; 30 employees in the construction sector; 15 in the trades sector; 100 in the services sector; and 20 in the finance sector (Small Business Secretariat, 1979, p. 6).[1]

Detailed information is available for 1976 and 1978 (Small Business Secretariat, 1981). The SBS estimates that the total business population exceeds 1 million firms excluding over 225,000 unincorporated businesses with sales of less than $10,000. Statistics are presented for those firms which are incorporated and those which are unincorporated but are not self-employed professionals, salesmen, farmers and fishermen: this total was 646,000 firms in 1976 and 724,000 firms in 1978. Ninety-four percent of the increase were firms with sales of less than $2 million: the increase would be less than the number of new firms because of the disappearance of firms between 1976 and 1978. The following facts relate to this group of firms:

[1] These figures have changed with inflation so that $2 million in sales now corresponds with about 50 employees in manufacturing.

	1976	1978
Total number of firms ('000)	646	724
Small firms as % of Total	97.2	96.7
Total sales ($billion)	371.9	489.5
Small firms as % of Total	24.7	22.2
Total Pre-tax Profit ($billion)	27.4	34.3
Small firms as % of Total	26.6	22.7

The following statistics relate to firms in four sectors, Manufacturing, Construction, Trade and Services which accounted for 427,000 firms (or 66% of the total of 646,000) in 1976, and for 516,000 firms (or 71% of the total of 724,000) in 1978 - Table 2-1.

In these four sectors in 1978, small firms accounted for 96.3% of the total number of firms, 23.4% of sales, 28.5% of the contribution to GNP and 42.2 of employment in 1978. Very little change has occurred since 1976. The importance of small firms in terms of sales, employment and contribution to GNP is over 50% in services and construction, between about 25% to 45% in trade, and between 7% and 16% in manufacturing. Other statistics, based on the operations of 129,658 profitable taxable corporations (in the four sectors in 1978), showed that small corporations accounted for 18.1% of the total taxes paid. In a survey of the sales of 11,491 manufacturers, small firms accounted for 0.6% of exports in 1978.

The ownership characteristics of the firms in the four sectors are as follows for 1978. Foreign-controlled firms account for 2.1% of the total number of firms and 36.0% of the foreign-

TABLE 2-1

SELECTED STATISTICS ON SMALL FIRMS' SHARE IN FOUR INDUSTRY SECTORS
CANADA, 1976 AND 1978

Small Firms as % of Total	Manu-facturing		Construction		Trade		Service		Total	
	1976	1978	1976	1978	1976	1978	1976	1978	1976	1978
Numbers	89.2	87.0	97.8	98.0	95.5	94.9	99.0	98.9	96.2	96.3
Sales	8.6	7.3	52.2	52.2	29.4	27.6	57.0	56.3	24.3	23.4
Contribution to GNP	12.0	9.8	53.0	55.0	37.0	34.0	58.0	57.0	30.3	28.5
Employment	18.6	16.1	69.7	71.8	46.1	42.8	68.6	72.4	41.7	42.2

SOURCE: Small Business Secretariat (1981).

controlled firms are small; Canadian controlled firms account for 97.9% of the total and 93.3% of the Canadian controlled firms are small. Thus, amongst the group of small firms, almost all of them, 99.2% are Canadian controlled, and there are relatively few foreign controlled firms, 0.8%. In terms of sales in 1978, the foreign controlled firms had 2.5% of the total sales of the group of small firms. Thus, the small firms in these four sectors are almost all Canadian controlled whether measured in terms of numbers or sales.

One indicator of the entry of new firms is shown by the number of new corporations established, which were 32,899 in 1977 in the four sectors: relative to 1976 this number represented an increa of 20.4% in services, 16.6% in construction, 14.3% in trade and 10.7% in manufacturing. Most of these new corporations were probably small at the time of their establishment. However, some of them may have been a change from unincorporated to incorporated forms of organization and thus no net increase in the number of small firms of all types.

2.3.1 Industry Distribution[1]

In 1978, the population of 724,000 firms was divided between 381,000 incorporated and 343,000 unincorporated firms. Small firms with sales of less than $2 million accounted for 358,000 of the incorporated group (94%) and all but 268 firms in the unincorporated group.

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[1] Based on data provided in computer printouts from the Small Business Secretariat, Department of Industry, Trade and Commerce, November 1981.

Incorporated Small Firms

In the incorporated small firm group, 54% of the firms were located in Ontario (35%) and Quebec (19%). Ten 3-digit industries, each with more than 10,000 small firms accounted for 52.3% of the total number and 38.5% of the total sales of small incorporated firms - see Table 2-2.

Unincorporated Small Firms

In the unincorporated small firm group, which represents 47.4% of the total number of small firms, 64% are located in Ontario (37%) and Quebec (27%). Almost all unincorporated firms are small firms. The main industries to which these firms are allocated by Province are shown in Table 2-3 which lists all industries in a Province which have more than 1,000 unincorporated firms.

2.3.2 Small Business Financing Review[1]

A study based on data for 1977, collected information on 1,127,000 entities in Canada whose income was not derived from wages and salaries, and which reported gross business income in excess of $10,000. From this group 599,000 entities were excluded such as farmers, fishermen, government owned enterprises and welfare and non-profit organizations, leaving a total of 528,000 entities which were divided into four groups (Overview of Small Business Financing, 1981, p. 7).

[1] For a detailed examination of the characteristics of the small business population see J. Whipp, E. Hughes and J.R. D'Cruz, A Profile of Small Business in Canada, A Background Report for the Small Business Financing Review (Ottawa: Department of Industry, Trade & Commerce, March 1982).

TABLE 2-2

3 DIGIT INDUSTRIES WITH MORE THAN 10,000 INCORPORATED SMALL FIRMS - NUMBER AND SALES , 1978

SIC No.	Name	Small Firms Nos.	Sales ($Bil.)
404	Building Construction	15,627	4.3
421	Special Trade Contractors	24,301	6.3
629	Wholesalers n.e.s.	10,152	2.8
699	Retail Stores n.e.s.	11,123	2.8
756	Investment & Holding Coys. n.e.s.	32,895	2.4
781	Insurance & Real Estate Agencies	11,914	1.7
791	Real Estate Operators & Leasors	29,187	3.4
793	Real Estate Developers & Sub-dividers	15,610	1.9
869	Other Services to Business Management	19,918	2.5
875	Hotels, Restaurants & Taverns	10,462	4.2

SOURCE: Small Business Secretariat, Ottawa

TABLE 2-3

PROVINCES WITH 3-DIGIT INDUSTRIES HAVING MORE THAN 1,000 UNINCORPORATED FIRMS, 1978

SIC	Name	Provinces						
		N.S.	N.B.	Que.	Ont.	Man.	Alta.	B.C.
031	Luggage			X	X			X
261	Household Furniture Mfg.				X			
404	Building Construction				X			X
507	Truck Transport	X	X	X	X	X	X	X
629	Wholesalers n.e.s.				X			
631	Food Stores			X	X			
642	Department Stores			X	X			
654	Gasoline Service Stations			X	X			
658	Motor Vehicle Repair Shops			X	X			
667	Women's Ready-to-Wear Stores			X				
669	Clothing & Dry Goods Stores n.e.s.				X			
676	Household Furniture & Appliances			X	X			

SOURCE: Small Business Secretariat, Ottawa.

Group	Firms Nos. '000	Firms %	Sales $Million	Sales %
1. Self-employment firms	295	55.9	10,286	2.9
2. 'Independent' small and medium size businesses	225	42.6	136,384	38.9
3. Affiliates - subsidiaries of larger domestic and foreign firms	7	1.3	41,173	11.7
4. Large scale firms	1	0.2	162,957	46.5
	528	100.0	350,800	100.0

The 'self-employment firms' are those firms where the owner provides most of the labour input of the business, and where little full-time employment is provided to persons other than the owner. The study decided that these firms required special analytical treatment, and thus focussed on Group 2, the 225,000 'independent' small and medium size businesses, most of which are incorporated and have sales ranging from $100,000 to $30 million. By definition these firms are Canadian-owned and independent in the sense that they are not in the third group, affiliates or subsidiaries of larger domestic or foreign firms.

The size distribution of the 225,000 firms is provided for 14 industries in terms of four quadrants. The firms were arranged in increasing order of sales size: the smallest firms that accounted for the first 25% of sales were placed in the first quadrant and the largest firms in the fourth quadrant - Table 2-4.

The sales range of each quadrant varies by industry, e.g.,

Table 2-4

Distribution of the Size of Firms by Quadrant for 14 Major Industries, 1977

(Independent Canadian Owned Incorporated and Unincorporated Firms)

Industry	Size Range (Annual Sales in $ Thousands) of firms in Quadrant			
	One	Two	Three	Four
Special Trade Contractors	$50-209	$209-701	$701-2,252	$2,252-30,000
Hotels, Motels, Cmpgrds, etc.	100-213	213-443	443-1,164	1,164-30,000
Food Stores	100-265	265-696	696-1,609	1,609-30,000
Building Const.	100-511	511-1,269	1,269-4,607	4,607-30,000
Gasoline Serv. Stations	100-269	269-409	409-710	710-30,000
Wholesalers, N.E.S.	100-508	508-1,300	1,300-4,769	4,769-30,000
Misc. Serv. to Bus. Mgmt.	50-172	172-516	516-1,313	1,313-30,000
Retail Stores, N.E.S.	100-254	254-601	601-1,269	1,269-30,000
Motor Vehicle Repair Shops	50-109	109-240	240-537	537-30,000
Household Furn. & Appl. Shops	100-278	278-588	588-1,225	1,225-30,000
Truck Transport	100-324	324-1,052	1,052-3,200	3,200-30,000
Motor Vehicle Dealers	100-2,390	2,390-5,403	5,403-10,074	10,747-30,000
General Merch. Stores	100-441	441-1,716	1,716-6,670	6,670-30,000
Wholesalers of Mach. & Equip., N.E.S.	100-838	838-2,080	2,080-5,414	5,414-30,000

SOURCE: Small Business Financing Review, A Profile of Small Businesses in Canada (Preliminary Report), Small Business Financing Review, Department of Industry, Trade and Commerce, April 3, 1981, p. 14.

1st quadrant motor vehicle repair shops have sales ranging from $50,000 to $109,000, while 1st quadrant motor vehicle dealers have sales ranging from $100,000 to $2,390,000. This approach results in each industry having a different cut-off point for each size category. Industry differences are due to the following type of circumstances: in the service industry (repair shops) where labour is a high percentage of sales, and there is a high value added to sales, the upper bound of the 1st quadrant is low; in retail trade (dealers) where value added to sales is low and purchased goods are high, the upper bound of the first quadrant is high.

This approach suggests that there should be a different cut-off point for small firms in different industries. Using the SBS standard of small firms having less than $2 million sales, then in the 14 industry groups, 1 group would reach this level with the firms in the first quadrant, 1 with firms in the second quadrant, 5 in the third and 7 in the fourth quadrant. This approach is consistent with the point made in the discussion of definitions, where it is argued that different cut-off points are appropriate for different industries.

The 'independent group' from which the small firms are identified are independent from large firms in terms of equity linkages and management control in the administrative sense, but may have quasi integration linkages, e.g., franchise arrangements, long term supply contracts, distribution arrangements, access to technology, use of advertised brand names,

managerial knowhow and training. Small firms in return may agree to market restrictions, geographic or product. In fact it may be that the lack of true independence of the so-called independent group is a key issue area for small firms. It also raises the question of how to define the boundaries of a firm, a topic which is addressed in Chapter 3. A discussion of the large-small firm contractual arrangements is contained in Chapter 4.

The industries with a substantial number of 'independent' businesses are shown in Table 2-5. Construction, Trade and Services are the predominant sectors in which these industries fall. The industries where the independents account for a high proportion (over 70%) of sales are listed in Table 2-6. The same sectors are well represented as in Table 2-5, with some representation from the manufacturing sector in terms of textiles, clothing and furniture.

2.3.3 Very Large Firm Statistics

More attention has been given by researchers to large than to small firms, and for this reason it is possible to note trends in the share of large firm activity in the economy. The residual then shows the share of small and medium size firms' activity. If the share of large firm activity has been increasing (or decreasing), then the share of small and medium-size firm activity must be decreasing (or increasing). The Royal Commission on Corporate Concentration (pp. 18-32) devoted fourteen pages to this topic, and concluded that aggregate concentration, in terms of the sales and asset shares

TABLE 2-5

SECTORS WITH SUBSTANTIAL NUMBERS OF "INDEPENDENT" BUSINESSES, 1977

Rank	Industry	Number of Firms	Cumulative Percent
1	Special Trade Contractors	33,078	14.7
2	Hotels, Motels, Restaurants	15,299	21.5
3	Food Stores	14,730	28.0
4	Building Construction	10,662	32.8
5	Gasoline Service Stations	10,420	37.4
6	Wholesalers, Not Elsewhere Specified	8,985	41.4
7	Miscellaneous Service to Business Management	8,892	45.3
8	Retail Stores, Not Elsewhere Specified	8,890	49.3
9	Motor Vehicle Repair Shops	7,981	52.8
10	Household Furniture and Appliance Shops	7,756	56.3
11	Truck Transport	5,968	58.9
12	Motor Vehicle Dealers	4,841	61.1
13	General Merchandise Stores	4,426	63.0
14	Wholesalers of Machinery & Equipment not Elsewhere Specified	3,948	64.8
	Sub-total	145,876	64.8
	All remaining	79,333	100.0%
	Grand total	225,215	

SOURCE: Small Business Financing Review, 1981, p. 10.

TABLE 2-6

Sectors where "Independents" Account for a Major Proportion of Industry Sales, 1977

Rank	Industry	"Independents'" Sales as % of Sector Sales	Number of Independent Firms
1	Tire, battery & accessories stores	91.9	2,233
2	Motor vehicle repair	91.7	7,981
3	Machine shops	88.4	1,032
4	Motor vehicle dealers	86.9	4,841
5	Clothing industry	85.9	1,382
6	Gasoline service stations	85.5	10,420
7	Special trade contractors	84.2	33,078
8	Drug stores	81.2	3,077
9	Hosiery & knitting mills	80.9	230
10	Building construction	80.7	10,662
11	Retail stores, Not Elsewhere Specified	79.5	8,890
12	Misc. personal services	79.3	1,165
13	Blacksmithing & welding shops	78.1	865
14	Photographic services, Not Elsewhere Specified	76.6	912
15	Miscellaneous repair shops	76.5	631
16	Household furniture & appliance stores	75.9	7,756
17	Wholesalers of scrap and waste materials	75.6	639
18	Signs & displays industry	75.3	280
19	Advertising services	73.9	1,062
20	Radio, television, & electrical appliances repair stores	73.2	555
21	Florists' shops	73.2	749
22	Men's clothing stores & custom tailer shops	72.8	1,522
23	Household furniture manufacturers	72.0	874
24	Woman's clothing stores	71.9	2,106

SOURCE: Small Business Financing Review, 1981, p. 10.

of the 100 largest non-financial corporations, had declined from 1923 to 1966, and that there had been very little change from 1966 to 1973. The data for the last fifteen years showed small increases or decreases depending on which group of large companies is used.

Statistics on the share of the largest 100 non-financial enterprises in Canada show that between 1975 and 1979, their share of sales rose from 36.0% to 37.3%, and of assets from 46.5% to 48.5%.[1]

On the basis of both the corporation and enterprise statistics, the share of the largest firms has increased only slightly in recent years. Thus the share of small and medium size firms has decreased only slightly as well. If this information is combined with the statistics of a net increase in the total number of firms, at least in terms of the number of new incorporations (a net increase after disappearances have been taken into account), then the conclusion is that, in recent years, the largest firms are getting larger at least in absolute terms, and the small and medium-size firms are getting more numerous and accounting for about the same share of total activity.

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[1] An enterprise is a group of corporations under a single controlling interest. In 1979, the 100 largest enterprises embraced 1,340 corporations. These data are published in Statistics Canada, Corporations and Labour Unions Returns Act, Part 1 - Corporations (Ottawa, Cat. No. 61-210), 1975, p. 126 and 1979, p. 130. Only data from firms with assets in excess of $250,000 and gross revenues in excess of $500,000 are reported. Thus, small firms are excluded from the survey.

In 1959, an assessment was made of the share of small business in total business activity in the U.S. from around 1900, in the light of reports dealing with trends in aggregate and industry concentration. The conclusion was that between 1900 and the 1950's, "large firms have grown larger, and the small firms more numerous" (Rosenbluth, 1959, p. 205). This study examined two opposed hypotheses: first, that

> ...technology and the dynamics of business are making for increasing concentration. In one line of business after another, small firms are being displaced by giant corporate combines, so that the small independent businessman, the 'entrepreneur' of classical economic theory is gradually disappearing from the scene (Rosenbluth, 1959, p. 192).

This position was espoused by Marx and later in the 1930's by Berle and Means (1932). The opposing view was (and is) that

> ...concentration has not increased (in the U.S.) since the turn of the century, and that both technology and the dynamics of business are constantly opening up new opportunities for small business. Great corporations exist, but their relative importance in the economy has not increased over the last fifty years (Rosenbluth, 1959, p. 205).

For the U.S., this position was argued by Adelman (1958) and Lilienthal (1953).

Data should be available to determine at least whether concentration is increasing or decreasing, but as the Royal Commission on Corporate Concentration noted, answers to this question need not be clear cut. There are several reasons for the confusion. First, some writers use "aggregate" and some "industry" concentration figures. Second, different base year dates are used to determine trends. Third, changes in a

four firm and an eight firm industry concentration ratio may give conflicting results. And fourth, measures of inequality based on the percentage of firms, as opposed to the absolute number of firms may suggest different conclusions. For example, in the U.S.,

> ...mergers among the smaller automobile manufacturers left concentration unchanged, if measured in terms of the three largest firms, raised concentration in terms of four firms, and reduced the degree of inequality (Rosenbluth, 1959, p. 198).

The study concluded that, in the U.S. in the 1950's, at least 99% of all firms were small, a finding similar to that for Canada in 1979. Thus any changes over time in the total number of firms is likely to be due to changes in the number of small firms. Between 1900 and 1957, the total number of firms (and thus small firms) in the U.S. declined, but this was due almost entirely to the decline in the number of farms in the agricultural sector. In 1910, there were 6.4 million farms or 69 farms per 1000 of population: by 1954 there were 4.8 million farms or 30 farms per 1,000 of population. At the same time in all other sectors, excluding farms and professions, the number of firms rose from 1.5 million in 1900 to 3.3 million in 1940 and 4.3 million in 1957, or from 21 firms per 1,000 population in 1900 to 25 per 1,000 in 1957 (Rosenbluth, 1959, pp. 196-7). In this sector of the economy the number of small firms has grown almost three times over a period of about 50 years. Opportunities for small firms in the U.S. appeared to exist, although, like lemmings they may have been

starting up and failing, and this pattern may have been repeated over the years.

The trend in aggregate concentration (share of the largest firms) by major sectors showed that from 1900 to the 1950's in the U.S., concentration increased in farming, but has remained much the same in the non-agricultural sectors of manufacturing, transportation, public utilities and banking. If this information is combined with the data on the increased number of small firms, then the aforementioned conclusion is reached that, "large firms have grown larger, and the small firms more numerous". However, concentration measured in terms of inequality will necessarily have increased, because the large firms are now a smaller percentage of the total number of firms, and their percentage shares of total output has not fallen as much because of their growth (Rosenbluth, 1959, pp. 204-5).

These data for an earlier period in the U.S. seem to be consistent with what the incomplete data in Canada are showing. If so, then "technology and dynamics are opening up opportunities for small business", and research needs to be conducted on what the opportunities are, what aspects of technology are relevant and how the dynamics work. Research is required at two levels, first to establish the trends in small business activity in Canada, overall, by industry sector and by individual industry, and second to assess the technological and dynamic factors.

A more recent survey of changes in the small firm sector in the U.S. was reported in the Report of the Subcommittee on Antitrust, Consumers and Employment (of the Committee on Small Business, House of Representatives, Nov. 9, 1978). A similar conclusion was reached for the period up to 1975, "it has become readily apparent that an increasing number of small business are being forced to share in a decreasing 'piece' of the 'economic pie'" (p. 18). Despite the increasing number of small firms, it was noted that concentration in individual industries was increasing due to the disappearance of small firms in mergers.

The suggested technological opportunities for small business in earlier years have been associated with the availability of electric power and transportation facilities which have allowed small firms to become dispersed geographically. In the 1980's the opportunities may be more closely related to the use and availability of data communications networks (computers and telecommunications) which allow firms to have access to managerial overhead equipment which was previously only available to large firms. If firm overheads can be reorganized into smaller units with no loss of efficiency, i.e., firm economies of scale are less important, then this may provide a reason for small firm growth and survival. Another hypothesis for testing is the view that start-up of small firms is related to innovative activity as seems to be the case in the electrical and electronic industries. In

Chapter 3 an examination is made of the findings related to firm size and innovation. The Canadian situation may, however, be different because of the presence of foreign subsidiaries (De Melto, 1980).

The dynamic opportunities may occur because of market situations generated by the growth of large firms. The issues to be examined here include the nature and extent of opportunities generated, as well as the subsequent factors which affect the new start-up firms as competitors with, suppliers to or customers of large firms.

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CHAPTER 3

EFFICIENCY CONSIDERATIONS OF SMALL FIRMS

The purpose of this chapter is to examine the economic rationale for small firms in terms of various concepts of efficiency. These concepts will be examined at three levels, (1) the firm, (2) the industry, and (3) the economy as a whole. At each level, the discussion will highlight what the literature in economics has to say about concepts of efficiency, namely technical, allocative, internal and dynamic efficiency as well as transaction cost considerations.

3.1 TYPES OF EFFICIENCY

Technical efficiency refers to the factors which affect the average cost of production as output changes, and is subdivided into a discussion of factors which are specific to the product, the plant, the firm, and the multiplant firm. For example, the increased volume of production of a given product may be associated with decreased costs due to the cumulative experience gained by workers and managers in operating the process, due to the reduction of cost increasing activities in changing machinery from one type of product to another, i.e., reduction of down-time, and due to management willingness to improve quality control procedures and to introduce cost-reducing automation. Plant-specific scale economies can arise due to indivisibilities in plant overheads such as management, maintenance, repair and inventories, causing average costs to fall as output expands. A further set of indivisibilities are examined in terms of firm-specific scale economies, namely factors such as

management, strategic planning, finance, advertising, research and development, distribution, insurance and legal services.

Multiplant economies of scale examine ways in which costs can be reduced by allocating production between geographically dispersed plants. A firm will balance product and plant specific production costs against the costs of transportation of both material inputs and outputs in determining the number, location and size of plants, which will minimise the costs of production and transportation. The process of franchising can be viewed as an alternative way in which firms react to the problems of distribution which promote multiplant operation (Curran, 1982, p. 21).

A second concept is allocative efficiency, or the efficiency with which resources are allocated between different uses in the economy. Allocative efficiency is frequently measured in terms of the relationship of price to marginal cost of a given commodity, or inferred from data on the profitability of firms. Internal efficiency, a third concept, examines whether a firm produces a given level of output in the cheapest possible way, or whether costs are padded due to 'organisational slack' which tolerates inefficiency and waste. The fourth concept, dynamic efficiency, is used to discuss the conditions which give rise to invention and innovation within a firm or industry. For example, is it large or small firm size, concentrated or unconcentrated markets which promote the process of research and development.

The final concept, transactions costs, approaches the question of efficiency from a different viewpoint. Economic organization

can take place through the coordinating actions of firms or markets. In firms organizational decisions are internalised, while in markets the organization results from the decisions of independent buyers and sellers. The question then arises as to the costs and benefits of internal-firm versus market organization, e.g., Bell Canada, a carrier, owning Northern Telecom Ltd., an equipment supplier, versus purchasing from independent equipment suppliers. The transactions costs approach recognises that there can be costs associated with market transactions which may be reduced by internalisation, thus explaining both the size and growth of firms. Examples of these different types of efficiency will appear in the following survey of the economic rationale for small firms.

3.2 ANATOMY OF A FIRM

In order to understand the determinants of size, it is necessary to break the firm down into its constituent parts. These parts can be described in organizational terms, such as functions, departments, divisions, plants and corporations, in terms of vertical, horizontal or conglomerate parts, and in terms of the transactions which are engaged in by the firm's decision makers. Each of

these approaches is discussed in the literature, and each has something to say about one or more of the efficiency issues which relate to the existence of small firms and are the concern of competitio policy.

3.2.1 Technical Efficiency

The extensive literature on scale economies examines technical efficiency relative to the plant, the firm, the multiplant firm and in terms of product specific factors. The Bryce Commission concluded that

> ...plant-level economies of scale, which are usually cited in discussions of size, are often of little relevance in evaluating firm size, vis-a-vis product economies, multiplant economies and economies of firm size. It is our conclusion that in many industries firm-level economies in Canada justify larger sized business than do plant-level economies (Royal Commission, 1978, p. 68).

The firm level economies the Commission considered to be most important in justifying large firm size were

> ...risk-taking ability, in undertaking new investment and in long term R&D, with the largest firm sizes probably justified in high-risk sectors such as energy exploration, aerospace and similar fields (Royal Commission, 1978, p. 68).

This finding will have to be contrasted with the later discussion of dynamic efficiency, which emphasizes the contribution of small firms to R&D and innovation. It is also interesting to note that studies of the oil industry state that at the exploration stage there are a large number of small firms.[1]

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[1] In the U.S. there are estimated to be about 9000 firms engaged in exploration, development and production of oil, ranging in size from individuals with wells producing less than 10 barrels per day to Exxon which produces 10% of the nation's oil - see Measday, (1977), p. 134.

The Commission examined certain firm-specific economies. Regarding research and development, the conclusion was that

> There seems to be sufficient evidence to suggest that large corporate size does confer advantages in carrying out research and development, as measured by expenditures. However, large corporate size does not seem to be a prerequisite for participation in the innovative process, and the benefits accruing to large firms seem to be confined to the latter stages of the process, i.e., investment and development (Royal Commission, 1978, p. 60).

In a background study, McFetridge and Weatherley (1977), found that an increase in firm size resulted in an increase in the number of patents per dollar of R&D outlay as follows:

1. in the electrical industry, among larger firms;
2. in the chemical industry, among firms with relatively large R&D budgets;
3. in the machinery industry, among firms with relatively small R&D budgets (Royal Commission, 1978, pp. 59-60).

The Commission's findings on firm-specific economies of management or administration were inconclusive. These economies at the plant or multiplant level should arise when

certain administrative and service activities of a fixed or indivisible size can be spread over a wide range of production levels of the same or different outputs.

> Studies on the relationship between size and administrative staff levels come to no firm conclusions, but Scherer et al. conclude that in only a few cases did management costs rise less than proportionately with size. For most firms, Scherer concludes that larger size brought higher unit administrative costs (Royal Commission, 1978, p. 61).[1]

Firm specific economies of marketing were found to provide lower costs for larger firms. The difficulty comes in deciding whether these lower costs are due to real or pecuniary economies. The advertising rate structure reveals that large advertisers pay lower rates, but this does not lead to the conclusion that the lower rates reflect lower real costs, nor whether small firms acting collectively could obtain rates similar to those charged to larger firms.[2] Acting collectively would probably result in higher transaction costs. The Commission was inclined to conclude that there were economies of scale in export marketing, and that size was an advantage when it came to exporting. This conclusion contradicted one set of empirical findings,[3] but supported the rationale for the existence of a Trade Commissioner Service in the Federal Government.

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[1] The reference is to Scherer (1975).

[2] The empirical findings by McFetridge and Weatherley (1977), pp. 72-92, used data samples better than those used in previous studies, but not representative of the total Canadian manufacturing sector, Royal Commission, 1978), p. 64.

[3] See McFetridge and Weatherley, 1977, p. 67. The same study concluded that "the gains from applying a trademark over a number of product markets are relatively small" (p. 71).

On firm economies in financing, the Commission concluded that,

> ...large companies do have a cost and access financing advantage vis-a-vis smaller companies, but that this advantage does not seem to be reflected in better performance (Royal Commission, 1978, p. 66).

This conclusion does not do justice to the background studies on the topic, which examine the effect of firm size on assembling a stock of capital, on allocating capital among various investment opportunities and on bearing risks, and where a distinction between real and pecuniary economies is attempted. (McFetridge and Weatherley, 1977, pp. 95-207; J. Scott in Caves, 1977, p. 227). The business literature supports a similar finding based on the fact that for small firms the flotation costs of a new equity issue is an indivisibility, which makes such a financing method exceedingly expensive for small firms.

These firm-specific considerations of technical efficiency suggest determinants of firm size and why small firms may or may not exist. Multiplant and product-specific economies are also relevant. Some multiplant economies are similar to firm-specific economies where the firm is a multiplant operation. In Canada, the geographic spread of markets would suggest an explanation for the existence of multiplant operations as firms try to balance transportation costs against production costs (Scherer, 1975, p. 26). However, in a comparison of 64 Canadian and U.S. industries, "...insofar as U.S. companies exceed the size of Canadian companies through multiplant

development, it is only through the possession of more plants classified to other industries" (Caves, 1977, p. 181). The average number of plants per company is the same in Canada and the U.S. where the companies are specialised to one industry (a single industry company), and the larger U.S. companies are ones which have plants in several industries (a diversified firm or multi-industry company). A further difference takes place at the product-specific level: in Canadian plants there appears to be more within plant diversification, whereas in U.S. plants there is more within plant specialization (Caves, 1977, p. 199). For example one could imagine a Canadian multiplant firm producing tires and each plant producing a wide range of tire sizes: in the U.S. a multiplant operation would specialize in the production of a given tire size in one plant and another size in another plant, and at the same time the U.S. firm might have plants producing refrigerators and stoves. The smaller size Canadian firm could be less efficient for two reasons: first, it may not achieve the firm economies of scale associated with a multiplant multi-industry operation, and second, it may not achieve product-specific economies of scale associated with more specialised plants in one industry.

The extensive literature on scale economies provides a basis for understanding the determinants of firm size in terms of technical efficiency. Neither the theory nor the empirical results are conclusive in terms of how large a firm has to be

to become technically efficient. The Bryce Commission concluded

> In spite of the amount of work that has been done on the subject of economies of scale, few firm conclusions have emerged, and for several reasons. First, there are several different economies of scale associated with the production of a given product (or group of products), and hence there are many definitions of what economies of scale are for any one industry. Second, the data to determine the economies of scale for firms in an industry are difficult to obtain, and the methodology for using this data is highly dependent on which definition of economy of scale is being used. Third, the different economies of scale associated with a specific industry interact with one another and with the other economic characteristics of the country in complex and changing ways. Even if all the economies of scale associated with an industry could be defined, untangled, and measured, the implications of these calculated values for economic policy are often unclear and probably limited to one country. Therefore researchers using one definition of economies of scale in one country may arrive at policy recommendations radically different from those of another group of researchers in another country (Royal Commission, 1978, p. 47).

Transportation Costs

One determinant of firm size, as noted by Caves, is the cost of transportation. Where transportation costs are a high percentage of the delivered price of an item, it may be more efficient to have smaller plants or firms and more of them. The large geographic size of the Canadian market and the widely separated cities, where the majority of the population resides, tends to fragment an industry into smaller plants or firms, especially where transportation is an important cost element.

Some findings are now available at the 3-digit and 4-digit SIC level for manufacturing industries in Canada. These findings show, for 36 manufacturing industries, the transportation

costs from producer to purchaser as a percent of the delivered price (producer factory door price plus transportation costs) for both domestic sales and export sales. For domestic sales, transportation costs as a percentage of delivered price range from 1.32% for 'other smelting and refining' to 19.97% for 'manufacturers of mixed fertilizers'. The other industries with percentage values in excess of 5% are (Skoulas, 1981, Appendix A, Table A3),

	%
Cement Manufacturers	9.44
Sawmills	7.30
Veneer & Plywood Mills	7.24
Manufacturers of Industrial Chemicals	5.99
Flour & Breakfast Cereals	5.77
Aluminum Smelting and Refining	5.40
Petroleum Refineries	5.27
Miscellaneous Wood	5.25
Pulp & Paper	5.14

This type of information could be used to explain why some plants or firms are smaller than they might otherwise be, such as by comparing them with the minimum efficient scale of operation. However, this could still mean that in absolute terms the firm was large, as is probably the case for aluminum smelters and petroleum refiners. Thus the influence of transportation costs might be to reduce the size of the firm, but still leave it with sales well in excess of $2 million which is the cut-off point used for small firms in this study, or the effect could be to promote multiplant operations, i.e., a large firm with small plants.

The study notes some other limitations: first, private

(not-for-hire) trucking costs are not included in the transportation cost totals, because the input-output table data used in the study do not permit their separate calculation; and second, transportation costs are affected by government policies such as subsidies which may distort the real costs of transportation (Skoulas, 1981, p. 28).

The use of data on transportation costs is relevant to explaining firm size, and this study provides a useful starting point for further research. The data provided will have to be related to other industry characteristics.

This review of technical efficiency in terms of various types of scale economies has been drawn from literature which has focussed on the determinants of large firm rather than small firm size. If the writers had been asked to examine where small firms are technically efficient, then they might have asked different questions. At least greater emphasis would have been placed on studying plants and firms in the service sector as well as in the manufacturing sector. Thus, while the reviewed literature is helpful in explaining the determinants of small firm size in terms of efficiency, future research should approach the topic directly in terms of small firms and the industries in which small firms are predominant, rather than attempting to derive implications from studies aimed primarily at explaining the existence of large plants and firms.

3.2.2 Allocative Efficiency

Small firms can affect allocative efficiency or the price marginal cost relationship as a result of their competitive interaction with other firms. In this context, horizontal, vertical and conglomerate mergers increase the size of firms, but are viewed as having possible anticompetitive effects. Vertical distributive arrangements such as franchising, exclusive dealing, tie-in sales, requirements contracts, consignment sales and resale price maintenance, are viewed as extending the scope of a firm's activities without necessarily extending the ownership boundaries of the firm. This approach to firm behavior is referred to as the 'inhospitality tradition' of competition policy based on D. Turner's statement that

> I approach territorial and customer restrictions not hospitably in the common law tradition, but inhospitably in the tradition of antitrust law.[1]

An opposing approach, associated with the Chicago tradition, argues that these business practices lead to more efficient resource allocation, and thus require a more lenient antitrust approach (see Williamson, 1981b).

Small firms are part of many of the vertical distributive arrangements discussed in the 'inhospitality-Chicago' debate, especially in the wholesaling and retailing sectors. The

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[1] Quotation attributed to D. Turner, former head of the U.S. Antitrust Division, by S. Robinson, 1968, N.Y. State Bar Association, Antitrust Symposium, p. 29.

abolition of resale price maintenance has always been opposed by associations of small retailers, such as the pharmacists, There is thus a need to determine, in the Canadian context, the implications for allocative efficiency of these business practices. This research should help to clarify the extent of the boundaries of the firm. For example, when a large firm supplies a small firm by way of a requirements contract or on consignment, does this make the small firm an extension of the larger firm, what effect does it have on the small firm's costs and on the price charged to the consumer?

3.2.3 Internal Efficiency

In addition to considerations of technical and allocative efficiency, concern is expressed that market power will be revealed not in terms of economic profit but rather in terms of higher than necessary costs. Firms with market power may have inflated costs due to items such as unnecessary office staff, obsolete equipment, organizational slack, and expensive offices. These items refer to discretionary costs which could be cut without affecting production (Leibenstein, 1966; Scherer, 1970, pp. 404-405). An alternative explanation is that discretionary expenditure leading to internal inefficiency is a function of the ability of owners to control managers, and is a cost of the agency arrangement in a firm (Jensen and Meckling, 1976).

Most of the examples of internal efficiency, or the lack of it, are drawn from large firms which have the ability to hide the padded expenses from their shareholders and the public. It is clearly very difficult

for an outsider to know what expenses are being incurred and whether these expenses are necessary to produce and sell the output. Moreover, a firm incurs expenses both for current and future production, the latter associated with exploration or research and development activities. The need for expenditures associated with future production is clearly based on judgement about future market conditions, and there can be differences of opinion as to whether these expenses are in some sense 'necessary'.

The application of the concept of 'internal efficiency' to small firms requires a somewhat different approach. The owner-manager of a small firm frequently combines his personal finances with that of the firm. Thus, in the same way that a farmer may consume part of what he produces, may live in a building part of which is an expense of running the farm, and may use a farm vehicle for personal transportation purposes, so a small manufacturer or retailer may be able to expense part of his personal living through his firm. The costs of the firm may become padded due to the blurring of the distinction between the owner-manager's personal and business life.

There are other ways in which small as opposed to large firms may be able to reduce costs and generate internal efficiency, often at the expense of the tax collector. The financial controls in a small firm may not be as tight, allowing for barter arrangements between suppliers and customers, kick-

backs, non-recorded expenditures and payment in kind. These activities may increase the before tax cost of doing business, but reduce the payment of taxes, with benefits accruing to the owner-manager. Internal efficiency is a concept to be examined in the context of small firms, but the activities to which it applies may be different to those in larger firms.[1]

3.2.4 Dynamic Efficiency

Two aspects of dynamic efficiency will be considered, the impact on costs of cumulative production or the importance of the learning curve, and the relationship of size of firm to research and development and the process of innovation. In certain industries unit costs are observed to fall with the cumulative volume of production due to the accumulation of experience by engineers, managers and workers.

> Studies of World War II aircraft production show that labor costs per unit declined by approximately 20 per cent on the average with every doubling of cumulative output (Scherer, 1970, p. 74).

Other industries in which the learning curve has been observed are machine tools and electronic apparatus where systems and complex products have to be developed (Hirshleifer,

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[1] An example of this practice in small firms in Italy was recorded recently in the Wall Street Journal, April 12, 1982, p. 18; "Although small businessmen don't admit it on the record, they have much greater opportunity than big businessmen to keep down costs and retain profits by cheating the tax collector. One technique is to avoid paying social insurance taxes for workers, a levy that amounts to 40% of the wages. Workers are paid in cash, and records of their employment aren't kept. The workers don't object, because then they don't pay tax on their earnings. Some small firms hire workers who have been laid off by larger companies, with the larger firms continuing to be responsible for the workers' health insurance and pensions." This is an aspect of the hidden or underground economy.

1962; Preston and Keachie, 1964). A firm which accumulates experience may be able to sustain a cost advantage over subsequent entrants. An older firm, even if small, may have an advantage over a newer and perhaps larger firm, due to the length of time it has been producing and its cumulative production.

Some high technology firms may accumulate experience in the process of innovation itself, i.e., with the development of a series of new products and processes. The product cycle theory of international trade and investment could be viewed as a description and explanation of how a firm develops and commercialises a new product or process, and when its competitive advantage declines for the new item, it starts the process again with another new product or process (Gruber, Mehta and Vernon, 1967). Such a firm benefits from its experience gained in innovation. The economics of cumulative production may be a factor which provides cost advantages to smaller firms.

The second aspect of dynamic efficiency, the relationship between firm size and innovation, has already been referred to in the discussion of firm scale economies. Scherer has reviewed the extensive literature on this topic and concludes that,

> No single firm is uniquely conducive to technological progress. There is room for firms of all sizes. What we want, therefore, may be a diversity of sizes each with its own special advantages and disadvantages (Scherer, 1980, p. 418).

and

> A little bit of bigness-up to sales levels of $250 to $400 million at 1978 price levels-is good for invention and innovation. But beyond the threshold further bigness adds little or nothing, and it carries the danger of diminishing the effectiveness of inventive and innovative performance (Scherer, 1980, p. 422).

Thus in terms of dynamic efficiency, while the literature does not stress the contribution of large firms to research and development, neither does it suggest that small firms are the major contributors. Even in terms of McFetridge's findings large firms can do at least as well as small firms (Royal Commission, 1978, p. 60).

Case studies provide selective evidence of the relationship as it relates to various stages of the research and development process - invention, innovation and diffusion (Jewkes, 1962). These studies suggest that "small firms and independent inventors play a prominent and perhaps even disproportionate role in generating the new ideas and concepts upon which the technological advances rest" (Scherer, 1970, p. 357). The later stages of innovation and diffusion may require the resources of larger firms.

In sum, there is conflicting evidence about the relationship of firm size and research and development. If the smaller firms have an advantage, then it appears to be at the invention stage of the process, especially with radical changes (Rothwell and Zegweld, 1981).

These two aspects of dynamic efficiency, the impact of the learning curve and cumulative production costs, and the impact of firm size on innovation are brought together in

Penrose's theory of the growth of the firm. In this theory, large firms are claimed to benefit by way of lower costs in almost all areas from accumulated experience.

> (Large firms') market connections tend to be more extensive, their standing in the capital market better, their internal funds larger - a successful past record is alone an enormous aid to further advance. They have accumulated valuable experience and, by virtue of their size, they can take advantage of many technological and organizational economies not possible at smaller scales of operation (Penrose, 1963, p. 218).

Large firms are assumed to have a competitive advantage over small firms in any field they care to enter, but this may not be sufficient to ensure that they will always be able to grasp all the opportunities for expansion.

> If, therefore, the opportunities for expansion in the economy increase at a faster rate than the large firms can take advantage of them and if the large firm cannot prevent the entry of small firms, there will be scope for the continued growth in size and number of favourably endowed small firms....
>
> I propose to call these opportunities for small firms the interstices left open by the large firms which the small firms see and believe they can take advantage of ...if the existing small firms are unable or unwilling to fill at the interstices, there will be scope for the successful creation of new firms. Plainly, we have a variant of the long familiar principle of comparative advantage: given limited resources, a firm that has an advantage over others in numerous fields of activity will find its most profitable expansion in those fields where its advantage is greatest (Penrose, 1963, pp. 222-3).

Penrose's theory explains the growth of small firms in terms of the combination of comparative advantage and low entry barriers. The interstices are expected to appear where

economic growth and technological change occur. Small firms can take advantage of these opportunities despite the advantages of cumulative experience which accrue mainly to larger firms. The characteristics of the firm stressed in this theory is "that a firm is essentially a pool of resources the utilization of which is organized in an administrative framework" (Penrose, 1963, p. 149). Certain of these resources are required to manage growth, but become available once a growth plan is implemented. However, their underutilization at certain times may result in pressures and incentives for further growth.

3.2.5 Transactions Cost

Another approach to the determinant of firm size pioneered by Commons (1934) and Coase (1937) and developed by Williamson (1981a) and others is the transaction cost approach. If the transaction is taken as the basic unit of analysis, then the issue is the circumstances under which it is more efficient to organiz activity through arm's length transactions across markets, as opposed t internalising transactions within firms. The more prevalent are the conditions which favour the latter, the larger the firms are likely to be on grounds of transaction costs. Or, the circumstances which favour small firms are those which favour arm's length (market) transactions.

The anatomy of a firm can be described in terms of transactions engaged in by the various units which make up a firm. In functional terms, these units consist of the procurement, production, research and development, finance, marketing, industrial relations and public relations departments of a

firm. Each department consists of a bundle of transactions, and relations between departments will involve further transactions. A small firm is one that finds it more efficient to have a limited array of departments and/or a limited size to each department. If the cost of contracting out to other firms for a particular function is low, then the firm may stay small. If contracting out costs are high, then the firm internalises the function, creates an organizational hierarchy and becomes larger.

The description of a firm in divisional terms is akin to its description in functional terms from a transaction cost viewpoint. A firm creates divisions on either product or geographic lines (Chandler, 1962 and 1977), and the costs of the basic unit, the transaction is then examined relative to the division and the relationship between divisions, similar to the discussion of functional departments. The multi-divisional hypothesis, stating that firms reorganize from multi-functional to multi-divisional organizations in order to improve performance, is based largely on transaction cost considerations (Armour and Teece, 1978). Small firms are therefore likely to occur where multi-divisional transaction cost savings are unimportant.

A further attribute of a transaction is its vertical, horizontal or conglomerate dimension. For any given production process, some functional departments are vertically related, e.g., procurement, production and marketing, while others provide support functions, such as finance

and industrial and public relations. The organizational structure of an oil company will tend to be primarily based on vertically related divisions, e.g., exploration, crude oil produetion, transportation, refining, and gasoline marketing, while for an automotive company it may be a combination of vertical divisions, e.g., engine, body, and assembly, and horizontal divisions, e.g., the assembly of small, medium and large cars. A conglomerate firm will likely have some divisions which are neither vertical nor horizontal. These vertical, horizontal and conglomerate dimensions have been described in terms of large firms. In small firms they will exist on a small scale. For example, the single proprietor, e.g., a printer, will have to be responsible for the vertical stages of procurement, production and marketing, even though there may be no separate functional department or divisional structure.

The anatomy of a firm, in terms of the transaction as the basic unit, has functional, divisional as well as vertical, horizontal or conglomerate dimensions. In transaction cost terms, as noted, a small firm is one which finds it more efficient to internalise less transactions, and a large firm is one that finds it more efficient to internalise more transactions. What then are the characteristics of a transaction that result in economic activity being organized by firms as opposed to markets? In terms of forward integration (the

vertical dimension), Williamson suggests consideration of three factors, economies of scope, externalities and asset specificity (Williamson, 1981a).

Economies of scope are realized when it is cheaper to combine two or more product lines in one firm or via a market contract than to produce them separately. In retailing, this occurs in department store operations where a wide range of products are sold

Externalities are important where there is the possibility that a retailer, for example, may debase or enhance the value of a manufacturers product. In the course of fulfilling a contract, the terms may not be to the liking of each party and difficult for each party to enforce, leading to the transaction becoming internalised.

Asset specificity refers to the situation where in a transaction the purchase of an item means that the buyer becomes committed to a product or a process, and, when the time comes to purchase a second similar item, it is not easy for the buyer to deal with other than the original supplier. Arm's length transactions may be unsatisfactory, if the buyer who needs the specific asset believes that he can be exploited by an arm's length seller. This feature of a contract has been developed by Klein (1978).

The combination of these three characteristics of a transaction are then claimed to determine the degree of vertical integration, and thus the size of the firms due to vertical considerations. For example, vertical integration is less likely to occur

where there are more economies of scope, less asset specificity, and no externalities, i.e., these are the transaction conditions favouring smaller firms on grounds of vertical integration.[1] Another way to look at these conditions is in terms of bounded rationality, opportunism, uncertainty and small numbers bargaining. Asset specificity gives rise to small numbers bargaining situations and the possibility for opportunistic behaviour. Externalities give rise to uncertainty about the way in which a buyer will handle a purchase, and the limited ability to know all the future circumstances surrounding a contract and to include these eventualities in the terms of the contract. Such transaction conditions may favour larger firms.

The transaction cost approach describes the firm in terms of basic units, namely, transactions and seeks to explain why firms internalise certain activities. The approach can be integrated with the other aspects of efficiency (technical, allocative, internal and dynamic) by viewing firm size as being a function of all these factors. Thus, the plant size of a firm may be due to plant specific scale economies (technical efficiency), but whether the firm owns more than one plant, or engages in research and development, may depend on transaction cost considerations. Competition policy has to evaluate the efficiency consideration of small firms and weigh up the costs and benefits of these approaches. The literature tends to deal with each approach separately and not to integrate the analysis. One partial exception to this is Williamson's discussion of the trade-off between technical and allocative efficiency in the case of mergers (Williamson, 1968).

[1] More scope economies may result in larger firms due to horizontal expansion but not due to vertical expansion.

Scale economy determinants raise questions about the technical efficiency of firms; transactions cost considerations deal with questions of the organizational efficiency of firms and markets; the 'inhospitality tradition' suggests that behaviour leading to firm size (either directly or indirectly) adversely affects allocative efficiency, and finally there are questions of internal and dynamic efficiency. In efficiency terms, the desirability of small versus large firms may depend on the trade off between these factors. The principles of organizational design are not claimed by Williamson to be exhaustive nor refined, but suggestive of how to decide, from a transactions cost viewpoint, the welfare effects of firms versus markets, and in this context the appropriate size of firm (Williamson, 1981a, p. 154).

3.3 ROLE OF SMALL FIRMS IN INDUSTRIES

A second approach, at the level of the industry, is to examine the impact of firm size on competition within industries. Firm size can affect the level of concentration, which in turn can affect the performance of industries, especially in terms of allocative efficiency. The debate over the 'Market Concentration Doctrine' is relevant to this issue (Goldschmid, 1974, pp. 162-145).

The effect of industry concentration on research and development involves firm size indirectly in those cases where

small firms are associated with more competitive industries. The original Schumpeterian argument about the relationship between monopoly and the introduction of technological innovations has been elaborated and tested by later writers (Schumpeter, 1950, p. 106). One survey of this material concludes that,

> All things being considered, the most favorable industrial environment for rapid technological progress would appear to be a firm size distribution that includes a preponderance of companies with sales below $500 million, pressed on one side by a horde of small, technology-oriented enterprises bubbling over with bright new ideas and on the other by a few large corporations with the capacity to undertake exceptionally ambitious developments (Scherer, 1980, p. 422).

In order for such a situation to exist, barriers to entry must be kept at modest levels, so that entry by small newcomers can occur (see Sturmey, 1958, p. 277).

3.3.1 Corporate Dualism

The role of small firms in industries has been discussed in the concept of economic dualism. Originally the concept was used in the literature on economic development, and more recently it has been applied to industries in industrialized countries.

The literature on developing economies put forward and examined the concept of dualism, and described it in terms of differences between firms and between sectors of the economy. One sector is typically described as being traditional and populated by small firms, while another sector is modern and

contains larger firms. It is then contended that problems arise in a developing economy due to a combination of sectoral and firm characteristics. Allowance can be made for some small firms in the modern sector and some large firms in the traditional sector, although the latter is unlikely. The writers have stressed that techniques of economic analysis used in the modern sector are inapplicable in the traditional sector (Boeke, 1953; Furnivall, 1948).

The concept of dualism has been applied to industrialised economies by Averitt (1968), Thompson (1973) and Galbraith (1973), and distinctions made between the characteristics of large and small firms. Averitt reaches a similar conclusion to Boeke, namely that a different type of economic analysis is required to explain the difference in the behaviour of large and small firms. Two questions need to be asked at the outset about dualism, first what are the stated differences between large and small firms and secondly, do they matter? The answers given are somewhat different when applied to developed and developing economies.

In developing economies, it is argued that firms in the traditional sector have different values, motivations, institutional arrangements and work habits. For example, the firms may operate in poorly functioning markets, where information is poor, barter is used and much of what is produced is consumed by the same persons; there may be a feudal land owning system, or a caste system which allocates jobs to individuals

and restricts upward mobility. In the modern sector, markets are better organized, money is used as an intermediary in transactions, and production is more capital intensive and less labour intensive than in the traditional sector. Larger firm size is seen to be both a characteristic of and a result of forces at work in the modern sector.

In developed economies, firm size rather than sectoral differences are stressed. Thus, it is argued that "Center firms differ from periphery firms in terms of economic size, organizational structure, industrial location, factor endowment, time perspective and market concentration" (Averitt, 1968, p. 1). Galbraith argues that industrialised economies consist of two systems, the "planning system", composed mainly of large firms, and the "market system", composed mainly of small firms. In the planning system the firm tends to be protected from its environment and even to shape that environment: the firm depends on internally generated capital, develops its own new products and processes, controls supplies through vertical integration and long term contracts, and shapes the demand for its product via advertising. The small firm in the 'market system', is alleged to be unable to undertake any of these actions satisfactorily.

In both sets of literature, the small firm is viewed as being at a competitive disadvantage, requiring not only consideration of a different set of factors to analyse its

performance, but usually leading to policy proposals to overcome the differences or alleged disadvantages. The concept of dualism is put to a number of different uses. In developing countries, it has been used to promote the restriction on competition by arguing against the entry of multinational corporations, or to advocate controls over their entry. Concern is expressed as to what will happen to firms in the traditional sector, and more especially what will happen to the opportunities for the development of local entrepreneurship. Not all writers have taken a defensive stand. Some, such as Lewis, have encouraged the development of a modern sector as a way of bringing about change in the traditional sector through competition (Lewis, 1950). In this view foreign investment is seen both as a technique of modernization, and as a way of using the country's unemployed or underemployed resources, especially labour.

In developed countries, writers have examined questions such as the competitive relationships between large and small firms both horizontally and vertically, the role of large and small firms in promoting innovation, the significance of planning in large and small firms, whether large but not small firms can influence the demand for their output, and the discretionary powers exercised by large as opposed to small firms. In a review essay, Mason concludes that the noted difference between large and small firms does not affect the analytical

approach which has been used to-date, one which he pioneered in developing.

> If the dualistic thesis were to be taken seriously, the field of industrial organization to which Joe Bain has contributed so much and in which, at one time, I had a certain interest, would have to be considered irrelevant and immaterial. Perhaps that is one reason I react so strongly against the concept as a useful contribution to the analysis of the American economy.
>
> There are also differences between the behavior of large organizations and small organizations worth taking into account in all these areas. But these differences do not, in my view, add up to anything that could be appropriately described as a dualism. There is too much diversity within the large scale and small scale sectors, and too much similarity between them (Mason, 1976, pp. 23-24).

The Canadian case can draw on both sets of literature on dualism. Canada is the host to extensive amounts of foreign investment - a developing country concern, and it has large and small firms in the same modern industry sectors - an industrialised country concern. On the first count, it has been noted that the behaviour and performance of foreign subsidiaries in Canada are different from those of Canadian-owned firms in the same industry, and that frequently the foreign subsidiaries are larger than the Canadian firms. The question of competition can be explored, because the foreign firms appear to have some advantages over Canadian firms due to ties to their parent companies. These issues can be incorporated in the traditional framework of industrial organization, and the establishment of the Foreign Investment Review Agency can be viewed as a procedure to examine the competitive consequences of foreign investment, including its impact on small firms.

The competitive relationships between large and small firms raise a different set of issues. The traditional relationships involving predatory behaviour, unfair trade practices, collusion, vertical integration and vertical marketing relationships are all handled by traditional approaches to competition policy. However, a preoccupation with corporate size still persists in Canada, as evidenced by the Royal Commission on Corporate Concentration, the Royal Commission on Newspapers, the Restrictive Trade Practice's inquiries into the Bell-Northern Telecom relationship, and now into the petroleum industry. One concern, loosely expressed in most of these inquiries, is the discretionary power of large firms. This is not the discretionary power which can be exercised in markets directly, but the discretionary power to influence governments to support their operations especially in times of stress.[1] For example, the large farm machinery, and automobile firms have been able to obtain large subsidies from the government due to special pleading; the petroleum industry has been the recipient of protective measures such as the National Oil Policy of 1961; and the uranium companies are alleged to have received government approval to be a party to an international cartel. This is not to argue that small business does not and cannot lobby successfully with governments, but rather that the scope for discretionary influence may be much greater with large firms.

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[1] This type of power is implied in Penrose, (1963), p. 218.

In sum, there appear to be grounds to agree with Mason's general scepticism about the analytical usefulness of dualism. However, there are a number of qualifications. First, there are important issues concerned with the competitive relationships between large and small firms, which are the concern of competition policy as now conceived. Second, large firms can exercise discretionary influence with governments which may not be available to small firms to the same degree. Continued use of such discretion could alter the structure of industries to the detriment of small firms, and thus undermine the benefits that flow from either less concentrated industries or from oligopolies having a fringe of small firms with whom to compete on the basis of price or new products. And third, in Canada, some large and some small firms, namely foreign subsidiaries are parts of very large firms, and the foreign dimension injects a competitive element for small firms,which may be absent when small Canadian firms compete against large Canadian as opposed to foreign firms.

3.4 ROLE OF SMALL FIRMS IN THE ECONOMY

There is little in the literature other than the sources already mentioned to explain why the economy should have a small firm sector of a particular size. The Bolton Report comes closest to addressing the issue, but concludes that

> No work has ever been done which would enable us to determine the optimum size-distribution of firms in an industrial structure and it is therefore very difficult to say that at any time there are too few or too many small firms (Bolton, 1972, p. 342).

If there is a case to be made for the promotion of small business, it would be helpful to know what the optimum size distribution of firms is in the economy, and then to devise policies, including competition policies, which achieve this outcome. The small firm sector can be described in statistical terms, but other than listing the benefits which allegedly flow from small firms, it is difficult to decide whether the small firm sector should be larger or smaller.

The case for small business involves arguing that the existing size distribution should be retained or altered, i.e., in favour of either smaller or larger firms. The conclusion of the Bolton Report was that, while there were undesirable barriers to the growth of small firms which could be removed by government policy, there were not grounds to provide positive discrimination in favour of small firms (Bolton, 1972, p. 91). The Bolton Report's implicit conclusion is that the existing distribution of firms by size is

about optimal, and that there is a role for small firms in the economy. At one point the Report notes "If small firms did not exist it would be necessary to invent them" (Bolton, 1972, p. 344). Thus, even though the Report is unclear about how the optimum distribution should be determined, it clearly sees a role for small firms in the economy.

This role is shown to have eight parts - Exhibit 3-1, the first six of which are stated to be self-rewarding, so that the performance ought to be reflected in the efficiency and profitability of the firms, while for the last two the Report argues that the entrepreneur may underinvest relative to the benefits which would flow to society, and thus government support may be justified. In terms of the earlier discussion of efficiency considerations of firm size, the eight roles can be classified roughly as dealing with technical efficiency - Nos. 2 and 3, allocative efficiency - Nos. 5 and 8, dynamic efficiency - Nos. 6, 7, and 8, and transaction costs - No. 4. Role No. 1 seems to refer to the quality of life and freedom for individuals to enter the business of their choice, which is a characteristic of a market economy.

It is not clear from the discussion why the normal functioning of the market will allow the small firm sector to fulfill the first six but not the last two roles without some government assistance. In fact, in the case of Role No. 1, it may be government sanctioned controls on entry which deny individuals and small firms the freedom to compete. For example, controls on entry into professions and regulations

EXHIBIT 3-1

ROLE OF SMALL FIRMS IN THE ECONOMY

(i) The small firm provides a productive outlet for the energies of that large group of enterprising and independent people who set great store by economic independence and many of whom are antipathetic or less-suited to employment in a large organisation but who have much to contribute to the vitality of the economy.

(ii) In industries where the optimum size of the production unit or the sales outlet is small, often the most efficient form of business organisation is a small firm. For this reason many important trades and industries consist mainly of small firms.

(iii) Small firms add greatly to the variety of products and services offered to the consumer because they can flourish in a limited or specialised market which it would not be worthwhile or economic for a large firm to enter.

(iv) Many small firms act as specialist suppliers to large companies of parts, sub-assemblies or components, produced at lower cost than the large companies could chieve.

(v) In an economy in which ever larger multi-product firms are emerging, small firms provide competition, both actual and potential, and provide some check on monopoly profits and on the inefficiency which monopoly breeds. In this way they contribute to the efficient working of the economic system as a whole.

(vi) Small firms, in spite of relatively low expenditure on research and development by the sector as a whole, are an important source of innovation in products, techniques and services.

(vii) The small firm sector is the traditional breeding ground for new industries--that is for innovation writ large.

(viii) Perhaps most important, small firms provide the means of entry into business for new entrepreneurial talent and the seedbed from which new large companies will grow to challenge and stimulate the established leaders of industry.

SOURCE: Bolton, 1972, pp. 83-4.

(of all levels of government) of the terms and condition of entry, and operation after entry, may restrict or discourage the start-up of small firms. In sum, the Bolton Report argues for the preservation of the small firm sector in terms of these eight roles, but provides little guidance as to how large this sector should be.[1]

The literature from other countries discusses the contribution of small firms to the economy in a similar vein. At a recent international conference on small firms, the following views extracted from written papers were expressed about small firms in Germany, Japan and Australia. These views are either paraphrased (double-spaced) or quoted (single-spaced) in Exhibit 3-2, 3-3, and 3-4.

In the statements from both Germany and Japan, the view is expressed that the small firm sector has a pro-competitive effect in terms of both static and dynamic efficiency. In the Australian statement the socio-cultural advantages of small firms are said to offset various inefficiencies which small firms experience.

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[1] Clearly there is more to be learned about small firms in the U.K. from the Bolton Report, but its conclusion on the question of the appropriate size of the small firm sector is as discussed.

EXHIBIT 3-2

ROLE OF SMALL BUSINESS IN THE ECONOMY OF GERMANY

- A country's economic objectives are achieved as a result of a free market economy - one that encompasses the greatest possible number and variety of efficient small, medium-sized and large enterprises.

- Small and medium-sized firms are important elements in the safeguarding of freedom, of equal opportunity, and of a rational sharing of economic responsibilities....such firms are the strength and mainstay of any free country's economy.

- Small and medium-sized firms are more efficient due to the absence of a complicated bureaucratic superstructure; are less susceptible to the ups and downs of cyclical influences and are a stabilizing influence in the economy; create a better working environment; are resistant to the problems of unemployment and of joblessness among young people; and are a counter-weight to the errors of economic planning.

- Not least important, small and medium-sized firms are important pillars of economic progress in a balanced relationship among large, medium-sized and small enterprises. Initiative and innovation is offered by the small and medium-sized firms. It is precisely our countries' small and medium-sized businesses that ensure the consumers' being supplied with a wide range of goods and services. In this way, our small and medium-sized enterprises guarantee a balanced marketing structure.

- The trend towards industry concentration is the major reason for the pressure by labour for co-determination, or 50-50 representation in the senior management of large firms.

Exhibit 3-2 cont'd.

An alternative to co-determination is an active role by small and medium-sized firms in the economy. An additional cause for concern is the fear that large firms are tending to invade via mergers the sector of the market that has traditionally belonged to smaller enterprises, and that these smaller firms are often no longer able to compete in these sectors.

SOURCE: P. Schnitzer, "Small and Medium-Sized Enterprises and Large Firms", 8th ISSB, Ottawa, October 21, 1981.

EXHIBIT 3-3

ROLE OF SMALL BUSINESS IN THE ECONOMY OF JAPAN

- The rationale for small business in Japan is argued mainly on the grounds of its contribution to competition.

> The objective of Japanese policy towards small and medium enterprises is, as part of economic policy as a whole, to nurture small and medium enterprises within a competitive industrial society by pursuing economic rationality. However, small and medium enterprises tend to be at an economic and social disadvantage in their competition with large enterprises. Therefore, merely introducing the competition principle without correcting this disadvantage in business activities runs the risk of preventing the realization of an effectively competitive environment.

- Small business has a particular role in the service sector by way of franchise arrangements, and in the manufacturing sector as subcontractors to large firms - the 'SHITAUKE' relationship. Small firms are also viewed as the originators of new industries, especially those concerned with computer hardware and software.

SOURCE: Tamosu Shaya, "Small and Medium Enterprises in Japan: Trade and Policies" - 8th ISSB, Ottawa, October 21, 1981.

EXHIBIT 3-4

ROLE OF SMALL BUSINESS IN THE ECONOMY OF AUSTRALIA

- In Australia, it is argued that small business has organizational and cultural advantages which offset, or more than offset, the diseconomies of scale suffered in the use and efficiency of capital, the spreading of overheads, or the buyer/seller power in the market.
- The advantages which small business have include, 'a more intimate culture' (better working environment), greater and more direct contact with customers, greater profit orientation and more product innovation. Disadvantages include shortage of management skills and capital, vulnerability to coercive or rigid market forces, less job security and a high failure rate. Small business is viewed as the middle ground between the extremes of capitalism and communism.

SOURCE: "Small Business and Large Enterprise - The Australian Experience", - 8th ISSB, Ottawa, October 21, 1981.

The efficiency considerations of small firms have been derived primarily from the literature in various aspects of economics. The directions for future research are discussed in Chapter 6. In the following Chapter an examination is made of the literature in management which discuss small firms. This literature emphasises the quality of the managerial inputs into small firms.

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CHAPTER 4

MAJOR PROBLEMS FACED BY SMALL BUSINESS

In this chapter, an examination is made of the major problems faced by small business as highlighted by Dun & Bradstreeet's Canadian business failure record, studies commissioned by government departments and agencies, by academics, practitioners and the membership of the Canadian Federation of Independent Business (CFIB) and the National Federation of Independent Business (U.S.).

4.1 DUN & BRADSTREET DATA

When firms encounter extreme difficulties failure often results, a phenomenon which is not atypical for small business. The probability of success for a small business undertaking is quite low.[1] "Approximately 50 percent of all failures fail within the first four years of their existence and nearly 70 percent fail during the first six years, as reported by Dun & Bradstreet" (Knight, 1981, p. 18). In 1980, 55 percent of the businesses that failed had been in operation five years or less, while 18.6% had been in operation ten years. The "starting year" of the businesses that failed are listed in Table 4-1. Dun & Bradstreet classify business failures as

> Those businesses that ceased operations following assignment, receiving order, or proposal; ceased with loss to creditors after such actions as execution or foreclosure; voluntarily withdrew leaving unpaid obligations; were involved in court actions such as receivership or arrangement, or voluntarily compromised with creditors (Dun & Bradstreet, 1981, p. 1).

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[1] Some observers question the business failure/success ratios because of the problems encountered in defining small business, and in estimating the total business population in Canada.

TABLE 4-1

DUN & BRADSTREET: AGE OF 1980 CANADIAN FAILURES

(The year in which the Concerns that Failed in 1980 Started in Business)

Starting Year	Per Cent
1980	1.2
1979	12.9
1978	15.2
1977	14.0
1976	11.8
1975	7.9
1974	6.8
1973	5.5
1972	3.3
1971	2.9
1970	2.6
1969	1.9
1968	2.0
1967	1.4
1966	1.0
1965	0.8
1964	1.0
1963	0.8
1962	0.6
1961	0.6
1960	0.7
1959	0.4
1958	0.4
1957	0.4
1956	0.3
1955	0.4
1954	0.4
1953	0.2
1952	0.2
1951	0.3
1950	0.4
1949	0.2
1948	0.2
1947	0.1
1946	0.1
1945	0.3
1944	0.1
1943	0.1
1942	0.1
1941	0.1
1940	0.1
1930-1939	0.5
Prior to	0.2
Total	100.0

SOURCE: Dun & Bradstreet Canada, The Canadian Business Failure Record 1980 (Toronto, Dun & Bradstreet, 1981). - Reprinted as published

Table 4-2 lists the failures by provinces for the years 1974-1980, and Table 4-3 presents Canadian bankruptcies by primary divisions of industry. Of the 6,595 failures recorded in 1980, the greatest number occurred in wholesale and retail trade, with 2,120 failures; services, with 1,645 failures; and construction, with 1,301 failures. Geographically, 79.2% of the failures occurred in Quebec (2,605 failures, with liabilities of $315 million) and Ontario (2,622 failures, with liabilities of $288 million). The ease of entry into many of these service related lines of business may account for their high failure rate.

There has been an obvious increase in the number of failures during this period - the 1980 total is more than double the 1974 figure. These figures, however, understate the extent of failures and the problems encountered by small business in Canada. Many small businesses are wound up or liquidated without ever going through the bankruptcy process, many others are forced into sale because the owners can no longer maintain them independently, and many of these would go bankrupt if they were continued as independent businesses.

According to Dun & Bradstreet the overriding reason for business failure was some lack of management expertise. Based on a sampling of opinions of informed creditors and information in Dun & Bradstreet's credit reports, it was found that the underlying causes of business failures in 1980 were:

(a) Lack of Experience in the Line (10.5%), Lack of

TABLE 4-2

DUN & BRADSTREET: CANADIAN FAILURES BY PROVINCES, 1974-1980

(Liabilities in Thousands of Dollars)

Province	1974		1975		1976		1977		1978		1979		1980	
	Number Nombre	Liabilities Passif	Number Nombre	Liabilities Passif	Number Nombre	Liabilities Passif	Number Nombre	Liabilities Passif	Number Nombre	Liabilities Passif	Number Nombre	Liabilities Passif	Number Nombre	Liabilities Passif
Newfoundland	10	1,795	3	480	8	613,862*	86	17,188	23	–	16	–	37	4,378
Prince Edward Island	3	82	–	–	4	348	6	2,802	11	–	4	–	6	380
Nova Scotia	29	2,224	62	35,118	76	15,883	88	10,489	86	22,356	71	20,884	91	10,154
New Brunswick	24	12,742	44	33,826	36	5,334	41	19,822	46	–	36	–	36	5,330
Quebec	672	128,954	971	180,486	966	181,863	1,349	412,866	2,047	249,083	2,039	237,900	2,806	314,578
Ontario	1,003	142,830	1,202	140,817	1,254	199,886	1,785	291,091	2,124	189,941	2,223	186,224	2,622	287,753
Manitoba	80	11,871	79	8,880	84	13,882	88	10,882	80	–	80	–	154	13,980
Saskatchewan	36	6,420	25	2,405	29	6,889	80	10,707	77	74,202	102	61,800	114	11,346
Alberta	177	16,724	193	38,856	192	38,917	121	27,940	222	–	280	–	445	70,156
Northwest Territories	–	–	–	–	–	–	–	–	1	–	3	–	4	255
British Columbia	278	86,896	284	61,640	352	88,447	588	188,157	677	70,184	686	58,342	482	64,484
Yukon	–	–	–	–	–	–	–	–	7	–	8	–	SEE	N.W.T.
TOTAL	2,812	377,526	2,863	471,757	2,976	1,173,411	4,131	961,795	5,511	605,327	5,648	573,730	6,595	782,966

* Come-By-Chance Refinery.

SOURCE: Dun & Bradstreet Canada, The Canadian Business Failure Record 1980 (Toronto, Dun & Bradstreet, 1981).

TABLE 4-3

DUN & BRADSTREET: CANADIAN BANKRUPTCIES BY PRIMARY DIVISIONS OF INDUSTRY

Total Year Canada 1980

(Liabilities are shown in Thousands of Dollars as Declared by the Debtors.)

	Number 1970	Liabilities in 000's 1970	Number 1971	Liabilities in 000's 1971	Number 1972	Liabilities in 000's 1972	Number 1973	Liabilities in 000's 1973	Number 1974	Liabilities in 000's 1974	Number 1975	Liabilities in 000's 1975	Number 1976	Liabilities in 000's 1976	Number 1977	Liabilities in 000's 1977	Number 1978	Liabilities in 000's 1978	Number 1979	Liabilities in 000's 1979	Number 1980	Liabilities in 000's 1980
PRIMARY INDUSTRIES	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	145	15,375	200	21,129	312	44,4
MANUFACTURING INDUSTRIES	371	109,376	447	163,241	434	83,364	399	123,887	346	113,180	358	153,382	457	778,512	511	394,710	392	64,051	534	66,524	532	96,5
CONSTRUCTION	362	56,854	398	52,546	478	50,845	488	73,870	436	60,156	512	92,398	506	86,582	779	119,611	981	131,892	1,145	122,477	1,301	150,6
TRANSPORTATION, COMMUNICATION & OTHER UTILITIES	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	284	14,348	343	20,308	431	34,2
WHOLESALE & RETAIL TRADE	1,284	78,165	1,421	82,900	1,504	79,950	1,432	91,063	1,271	127,240	1,456	170,270	1,487	157,960	2,184	351,836	1,871	164,492	1,882	160,345	2,120	208,5
FINANCE, INSURANCE & REAL ESTATE	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	133	26,566	203	52,353	254	94,2
SERVICES	270	20,499	363	28,646	432	35,747	399	31,353	459	76,952	537	55,707	526	150,357	657	95,638	1,705	188,571	1,341	130,595	1,845	184,2
TOTAL	2,287	264,894	2,627	327,333	2,848	249,906	2,718	320,173	2,512	377,528	2,863	471,757	2,976	1,173,411	4,131	961,795	5,511	605,327	5,648	573,730	6,595	782,9

*1978 to 1980 figures prepared from Consumer and Corporate Affairs Canada Bankruptcy Statistics. Prior years include bankruptcies and other failures as reported by Dun & Bradstreet Canada.

SOURCE: As in Table 4-1.

Managerial Experience (9.0%), Unbalanced Experience (10.1%) and Incompetence (66.0%), all of which are grouped together, under the heading of Managerial Incompetence (95.6%). These were evidenced by an inability to avoid conditions which result in: inadequate sales (41.3%); heavy operating expenses (46.9%); receivables difficulties (0.9%); inventory difficulties (1.9%); excessive fixed assets (1.2%); poor location (0.3%); competitive weakness (5.6%); and other (1.6%).[1]

(b) Neglect (0.7%) due to: bad habits (0.1%); poor health (0.2%); marital difficulties (0.1%); and other (0.3%).

(c) Fraud (0.4%) on the part of principals, reflected by: false financial statement (0.1%); premeditated overbuy (0.1%); irregular disposal of assets (0.2%); and other (0.1%).

(d) Disaster (0.3%), such as fire and employee fraud, some of which could have been provided against through insurance, and

(e) Reason unknown (3.5%).

A similar situation was evidenced by Small Business Administration in the United States where 92% of all failures were attributed to mismanagement (Knight, 1981, pp. 18-19).

In recent years some businessmen and academics have begun to question the criteria employed in defining failure, and thus

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[1]Since some failures were attributed to a combination of apparent causes, the total exceeded 100% (Dun & Bradstreet, 1981).

the failure rate. One U.S. observer noted:

> The fact is that no one knows the start up rate or the failure rate. In fact, we don't even know what "failure" means. Do we mean bankruptcy? But many people go out of business without declaring bankruptcy, work like hell to settle every debt even though they have to close the doors of their business.
>
> Others close because their owners reach retirement age and have no one to turn the company over to. Still others shut down because they are bored. Are these businesses failures? (Shapero, 1981, p. 16).

A research study which tried to avoid the definitional problems associated with the Dun & Bradstreet failure criteria was a study undertaken by Star and Massel (1981). The Illinois Retailers' Occupational Tax data base was employed for a historical analysis of 17,252 retail firms established in 1974 in Illinois. These businesses were tracked through October 1979. Table 4-4 shows the survival rates calculated by Star and Massel for each kind of retail business; ranging from the highest for farm equipment dealers, motor vehicle dealers, lumber yards and other building materials dealers, drug stores, and hardware stores, to the lowest for eating places (non-alcoholic beverages), gasoline service stations and grocery stores.

The mean survival rate for all 17,252 retailers was 33.2 percent for the 5.3 year period. This is a far cry from the "90% of all new businesses fail in five years", or "95% of all businesses eventually fail" headlines which the authors charged involved the misuse of Dun & Bradstreet's failure statistics.

A Canadian observer of the small business scene contends

TABLE 4-4

SURVIVAL RATES BY KIND OF RETAIL BUSINESS IN ILLINOIS*

Kind of business	Number started in 1974	Percentage active in October 1979
Farm equipment dealers	110	63.6
Motor vehicle dealers (new and used)	127	55.9
Lumber yards and other build. materials dealers	116	53.5
Farm and garden supply stores, n.e.c.**	83	53.0
Hay, grain, and feed stores	66	51.5
Drug stores	203	50.7
Hardware stores	230	49.1
Drapery, curtain, and upholstery stores	95	46.3
Shoe stores	88	44.3
Furniture stores	149	44.3
Misc. automotive dealers	241	44.0
Jewelry stores	170	43.6
Book and stationery stores	168	43.5
Household appliance stores	76	43.4
Tire, battery, and accessory dealers	279	43.4
Paint, glass, and wallpaper stores	68	42.7
Antique stores	501	42.5
Florists	221	42.1
Mens and boys clothing and furnishing stores	109	41.3
Liquor stores	234	40.2
Used-car dealers	465	38.9
Dry goods and genrl. merchandise stores	68	38.2
Sporting goods stores and bicycle shops	406	37.7
Eating and drinking places	745	36.5
Music stores	151	35.8
Food stores, n.e.c.	109	35.8
Misc. stores, general merchandise, n.e.c.	224	35.3
Misc. home furnishings stores	114	35.1
Automatic merchandising	134	35.0
Radio and television stores	164	34.8
Misc. retail stores, specialized, n.e.c.	2061	34.2
Floor-covering shops	157	33.8
Misc. apparel and accessory stores	125	33.6
ALL RETAIL	17,252	33.2
Women's ready-to-wear stores	192	31.8
Drinking places (alcoholic beverages)	1403	30.5
Direct-selling organizations (including door-to-door)	949	30.0
Family clothing stores	92	29.4
Mail-order houses	199	29.2
Gift, novelty and souvenir shops	572	28.9
Meat and fish markets	143	28.7
Secondhand stores	193	27.5
Limited price variety stores	62	27.4
Grocery stores	962	27.0

*Only categories with 50 or more new starts in 1974 are listed.
**n.e.c.: not elsewhere classified.

SOURCE: A.D. Star and M.Z. Massel, "Survival Rates for Retailers", Journal of Retailing, Summer 1981, Vol. 57, No. 2, p. 92.

that

> The 'failure' of a small business is too often incorrectly defined and stereotyped according to concepts which are better suited for large business research and the mass statistics gathering procedures of organizations like Statistics Canada. In particular what is often described as failure of small business, does not necessarily mean that a legal bankruptcy has occurred, brought on by causes that could have been avoided through better management. Any Registrar of Bankruptcy will tell you that, relative to the number of businesses that disappear from statistical rolls, few are actually forced to go through formal bankruptcy proceedings. Many just cease to exist, for varied reasons, only some of which should be deemed to have failed as such (Peterson, 1981b, p. 2).

Undoubtedly there is some truth to these two observations, but supporting evidence and alternative ways of defining failure, particularly the nature and extent to which "other reasons" operate has yet to be developed and documented. For the present, Dun & Bradstreet findings both in the United States and Canada have permeated the management literature on small business.

4.2 SMALL BUSINESS LITERATURE

Much has been written about the problems of small business and the reasons for the failure of smaller enterprises. Major issue areas include: the inherent characteristics of the owner-manager, who in essence is the business; lack of strategic planning; problems in the areas of accounting, control and financing; shortcomings in the general area of marketing; and government regulations.

4.2.1 Entrepreneurial Characteristics

Considerable research has been conducted in recent years into the personal qualities and behaviour of entrepreneurs in order to increase the available knowledge about what makes successful entrepreneurs different from unsuccessful ones. J.A. Timmons links a number of personal characteristics, role pressures and requirements to successful entrepreneurship (1978a). Some entrepreneurial characteristics such as goal setting can be developed. Certain role requirements, such as knowledge of a particular business can also be learned. Identifying any major shortcomings or data flaws early in the process is essential, since these shortcomings can lead to failure.

In an article entitled, "The Failure Syndrome", the authors identified a number of symptoms that would help predict the failure of small businesses. This research involved the examination of 359 small businesses in the Chicago area which were having financial difficulties and which had sought the assistance of the U.S. Small Business Administration (Larson and Clute, 1979). In brief, many businessmen who failed or are likely to fail have certain personal characteristics they share in common.

First, they are likely to emphasize technical skills. The contention is that businessmen who exhibit the failure syndrome tend to de-emphasize the importance of management skills, while overstressing the importance of their ability as artisans or craftsmen. Another characteristic exhibited by a potential

business failure is the emphasis on the "school of hard knocks" approach. The denigration of the formal education process is perhaps a normal response for those who lack a college education. These businessmen are unlikely to enroll in programs that will improve their knowledge of accounting, finance, management or marketing.

The U.S. pattern is in part mirrored in Canada as well. Owner-managers of many small firms have been found to lack formal business education, and their work experience has tended to be in the technical-practical area. Based on material obtained from the Dun & Bradstreet lists of Ontario bankruptcies, coupled with interviews involving the bankruptcy trustees for a select number of firms, R.M. Knight noted that,

> The main problem encountered in the small businesses surveyed were those of the management ability of those people involved with the firm. These managers were typically technical or operationally oriented...Their backgrounds were typically as crafts-people or inventors rather than being general managers. For example, someone involved in the trucking business would start out driving a truck and then decide to start a firm, often as a broker or single operator. The size of the fleet was gradually increased and a trucking company was formed around the technical experience. In the wholesale business, an individual who had worked as a sales representative for some company would get into the wholesale business as an actual extension of that ability. This was the closest we found to a general management background in the small companies involved (Knight, 1981, pp. 17-18).

In those instances where other management responsibilities were included in their previous career positions, they were rarely of a general management type.

In the Knight study, "the typical failure firm of the 100

firms examined is a small business with sales of less than $200,000, assets of under $100,000, only two or three employees and one owner-manager, involved in running it" (Knight, 1981, p. 22).

Owner-managers of small businesses often were not sufficiently well prepared, managerially, psychologically and financially, to cope with protracted initial difficulties. They were unrealistic in their original technical and marketing expectations, in assessing the cost of doing business, and in estimating how much their firms could gross. When their difficulties began to mount and become more complex, the owner-managers experienced increasing problems in making adjustments to the new realities, which were far less attractive.

> The greater the commitment, the more the identification with the venture is internalized.
>
> If an individual fails, the experience can be shattering. In addressing the causes of a venture's failures, the entrepreneur himself is always one of the reasons. He planned poorly, he executed poorly, he followed through poorly, or in some way he did not allow sufficient margin for the unexpected (Liles, 1974, pp. 13-14).

4.2.2 Lack of Strategic Planning

Inadequate performance of the management function, specifically as it relates to effective decision-making and planning is a primary cause of many of the problems encountered by small firms. One author noted that "strategic planning behaviour in the small business firm is unstructured, irregular

and incomprehensive" (Still, 1974). Another authority, addressing the same issue, concluded that,

> ...strategic planning in small business is incremental, sporadic, reactive and primarily in the mind of the entrepreneur...while large firms have the advantage of staff specialists to help in this regard, the small business manager lacks such assistance and must constantly demand his attention. This is done...at the expense of planning activity that looks at the future, if only one or two years hence (Cooper, 1977).

One U.K. authority observed,

> Probably the greatest problem of the chief executive of the typical smaller business, and from this stem many other problems, is that he is so preoccupied with its day-to-day activities, of which he only too often carries out many of the direct operating chores himself--sometimes for apparently overpowering reasons of overall economy--that he gives little or no time to appraisal and improvement of current performance, or to the longer-term needs and prospects of the business. This frequently results in crisis management and ad hoc decisions--the antithesis of strategic planning (Perrigo, 1972, p. 57).

The concern over control and the initial downgrading of the non-technical aspects of management turn the owner-manager into an amateur general manager. For example, entrepreneurs on forming a small technical-based company may find themselves so preoccupied with raising capital, generating market opportunities, training personnel and performing other administrative duties that they are unable to devote the required time and effort necessary to manage the commercialization of the product. Unwillingness to delegate control even in the technical area, or an inability to impart the technical know-how to one's subordinates often leads to unnecessary complications and delays.

The general lack of management sophistication, particularly in the areas of finance and marketing, often undermine the potential success of numerous operationally sound projects.

The principle of delegation is misunderstood by many owners of small businesses. Assistants are frequently hired but are not permitted to do anything meaningful. The result is low productivity, low profits or large losses, poor employee morale and an overworked proprietor (Larson and Clute, 1979). Most owner-managers find the first step of reorganizing the activities of their subordinates to be logical and important, but find it more difficult to delegate them to their subordinates. Some of the chief executives do not know, and seem incapable of learning, how to delegate authority and responsibility (Perrigo, 1972). High potential operations are rarely sole proprietorships, partly because one person operations are quite limited in their maximum potential. For this reason, investors place considerable emphasis on the demonstrated capacity of the lead entrepreneur to attract, motivate and build a high quality entrepreneurial team (Timmons, 1978b).

Instead of hiring professionaly competent employees to oversee some of the operations of the firms, many owner-managers prefer to do everything and be everything to everybody. In many instances, where some control was given up, the timing was frequently too late to introduce the necessary corrective action to salvage some of the ventures. Reticence to share management control, and the downgrading of the non-technical

areas of expertise often result in the hiring of personnel whose financial and marketing expertise leave much to be desired.

The delegation hurdle probably causes more businesses to fall short of their potential than any other. The typical entrepreneur will resist giving up authority and control to subordinates, since he feels that he is the only one who knows the business. Many executives resist delegation for psychological, intellectual or emotional reasons, but this resistance poses a serious barrier to the success of the firm (Litvak and Maule, 1980). To successfully climb this hurdle, the entrepreneur must have top flight assistants (Parks, 1977).

In 1978, a number of Federal government industry sector studies indicated that the lack of management sophistication on the part of small firms was an obstacle to their ability to achieve further growth and profitability. For example,

> In general, management in the Canadian footwear industry is very competent in those areas required to establish and operate a small plant in an industry dominated by entrepreneurs. However, recent changes in the industry have made it important that management be proficient in all areas of business. Unfortunately, owner-managers of the small firms typically do not possess the full range of management skills and find it difficult to attract managers with these skills into the industry. The larger multi-plant firms have been much more successful in attracting professional management and correspondingly have been more successul in maintaining their position in the industry (Macleod, 1978, p. 7).

And,

> Specialized management skills are generally beyond the means of small companies in the (furniture)

> industry and only the larger firms are operated by professional administrators and managers.
>
> The changing economic environment of the industry, however, is making it increasingly important for furniture firms to have a much wider range of management skills, particularly in marketing (Neufeld, 1978, p. 5).

Planning procedures, operational guidelines and contingency plans are rarely evident in the management of these small companies. First attempts at stating company objectives, surveying market possibilities, and assessing fully the commercial feasibility of the product or process often occurs when the small business owner-manager applies for financial assistance either from business or government.

Budgeting and financial planning are essential for any small business, particularly those with growth aspirations. Many techniques developed for resource allocation and management in large corporations, while having conceptual validity, are simply impractical for most small enterprises; they are too cumbersome, unnecessarily elaborate, and too time consuming and expensive. Yet if the small enterprise is to progress beyond the survival stage, additional management tools are needed.

4.2.3 Accounting and Control

In the Larson and Clute survey of 359 firms, 143 or 40 percent of the firms were found to have financial difficulties because of accounting problems (1979). These were companies that required financial assistance because of the misuse or non-use of accounting data, not because of the lack of sales

or ill-developed marketing strategy.

Approximately 40% of the 143 firms suffered from inability to control inventories as the major cause of their financial plight. The majority of these firms simply had no system of maintaining cost-effective level of inventories. In some instances, sales were lost because the product was not held in inventory when it should have been; more frequently, items were overstocked, tying up much needed capital.

The second and third most frequently found accounting problems were nonexistent and inadequate accounting records. Nearly 20% of the 143 firms with accounting problems had no trained accountant. A surprising number of firms, 18%, showed incompetence or were indifferent to the accountant as the major cause of financial distress.

Numerous studies of problems encountered by small businesses in Canada recognized the significance of the accounting and control areas of activity; i.e., the lack thereof. For example, one study attempted to gain insight into the type of problems experienced by small businesses which had participated in twelve Ontario Government sponsored University Small Business Assistance Programmes during 1974-1976. The files of 1,066 firms were examined: about 30.9% of the sample were drawn from services, 25.6% from the retail sector, 24.9% from manufacturing, 6.5% from the wholesale sector, 6.5% from transportation and communications, and the balance from the construction, mining, agriculture and finance sectors. Of the 1,690

problem areas identified, 571 were of an accounting type and included: bookkeeping systems; internal control; cost control systems, and financial advice (Peterson and Smith, 1979).

The main problem in record keeping facing many firms is a complete lack of an organized information system. Still other firms may have some form of financial records, but they lack the detail necessary for managerial decision making, and for reporting the firm's liquidity position and taxable income (Said and Hughey, 1977).

The experience of the Clarkson Company (Canada), an accounting firm suggests that the absence of serious planning and control is by far the oustanding management shortcoming component. It is usually the case with insolvent companies that little effort has been made to develop operating, balance sheet and cash flow forecasts on a monthly, or even quarterly basis to cover the forthcoming year, nor have financial statements been prepared to parallel the forecasts. In these circumstances, management is flying blind (McKinlay, 1979).

Cash Flow Problems

A promising start can be wiped out by poor cash management. A growing business requires increasing investments of cash in accounts receivable, in inventories, and in fixed capital investments. The typical lag in the collection of accounts receivable often due to sales made to poor credit risks in order to keep sales moving, coupled with relative slowness in

inventory turnover which may result from over-optimistic sales projections and poorly administered inventory control methods and ill-timed capital investments, will all combine to create a major cash crunch. This situation has forced more than one young company into bankruptcy.

In numerous insolvent companies, cash budgeting was non-existent (McKinlay, 1979). Such situations tend to further undermine the financial viability of the firm because it destroys whatever confidence the company's banker might otherwise have had in the business, thereby seriously limiting the possibilities of a financial reorganization.

4.2.4 Financing

> To speak of the financing needs - working capital, term debt and venture capital - of small business as though all those entities covered by a particular size definition had common attributes, and hence common financing requirements, is to ignore reality. Capital requirements are known to vary according to many factors: the stage of development (start-up, rapid expansion, mature, declining); the nature of the sector in which a business is operating; conditions in the sector (excess capacity, stagnant demand, foreign competition, changing tastes). Capital supply conditions are known to vary as well, depending on a number of factors: size of transactions; nature of the assets; track record of the entity; location of the firm; the character, capacity and capital of the entrepreneur (An Overview of Small Business Financing, 1982, p. 7).

The need for capital funds is one of the most challenging problems facing small business. Studies indicate that for many of the owner-managers their company's capital structure, at the time of incorporation, consisted largely of their own cash and savings, which in some instances, was barely sufficient to cover

the expenses of incorporation. In addition to the owner's savings, other sources of initial capital investment included family, friends, financial institutions, suppliers, former employees and prospective customers (Boswell, 1972).

The relationship of cash, stock and credit in running a business was only vaguely understood. The owners of small businesses tended to invest their total savings at the outset, and as problems arose during the formative stage of business development, many of them were in the unenviable position of not having reserves to draw on to tide them over their difficulties. Some had difficulty in distinguishing between their business and personal finances. The financial implications arising from the foregoing difficulties is illustrated in the following example involving a Halifax Men's and Boys' Wear operation:

> J. Goldberg's dreams were grandiose. He would transform Goldberg's from a good, local (Halifax) business into a thriving regional--maybe even national--chain. He began opening new stores in every shopping centre in every small community he could find. By 1978, there were 14 outlets...65 employees, huge inventories and bigger loans. 'One year, we did $4 million worth of business...I didn't stop to think it wasn't profit.'
>
> Goldberg began living like a man whose company was making $4 million in profits, but he was--as he is the first to admit today--sadly lacking in business acumen. 'I was trying to compete against the big guys like Tip Top and companies like that, but I was trying to do it all by myself. They had whole divisions of people doing their buying and accounting. I had me. I didn't even have a comptroller, I--a guy who flunked accounting in college...'.
>
> To turn a serious situation into a disaster, Goldberg then ran up against the recession and sky-high interest

> rates. 'If you have to borrow money today (1982)', he told an interviewer in the midst of his company's financial woes, 'you're finished' (Kimber, 1982, p. 27).

For most small businesses in Canada, the main institutional financial contact is the local bank, while other sources of financing tend to be shareholder loans, where the shareholders are often friends, suppliers and customers. However, the Canadian banking system has been criticized for being overly conservative, and commercially naive in their assessment of business propositions.[1]

In a study involving 112 "successful" entrepreneurs in the Canadian secondary manufacturing sector, the majority of whom had companies with a sales volume of less than $1 million, financing the operation was considered to be one of the most difficult problems (Litvak and Maule, 1979).

In approaching financial institutions, the experiences of the entrepreneurs suggested that they were obliged to "prove" the ultimate commercial success of their ventures before establishing eligibility for a loan. This, they felt, was inconsistent with the very risk-taking nature of entrepreneurial ventures. Therefore, as noted previously, it is not surprising that personal savings and loans from relatives and friends were such important sources of finance. Even when granting financial

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[1] For a detailed examination and discussion of the financing problems facing small business in Canada, see An Overview of Small Business Financing, A Report of the Small Business Financing Review Team (Ottawa, Department of Industry, Trade and Commerce, May 18, 1982).

support through loans, financial institutions (chartered banks, in particular) did not escape criticism because of the "unfavourable" terms under which the financing was extended. Many entrepreneurs commented that there is no general shortage of capital, but that too little of it is being channelled into entrepreneurial ventures in the form of risk capital.

To obtain insight into the financing needs of small businesses, the Small Business Financing Review Team commissioned a number of studies. One involved a survey of 300 direct interviews with "independent firms"; i.e., firms with annual sales in excess of $100,000 but less than $30 million. Some of the major findings included the following: (1) chartered banks were the most preferred source of short and long-term funds; (2) banks generally provided "very good or adequate service"; (3) "financing gaps" in the small business capital market was "a matter of popular perception rather than a problem in reality"; (4) financing was less of a problem than marketing, production, personnel, inflation and cost controls; and (5) small business was generally not well informed of government programs designed to aid their activities (Facsym, 1981).

The possible existence of capital market discrimination has been the subject of a voluminous literature. Conclusions regarding whether discrimination exists are in part a matter of definition. Capital is not and should not be available to all would-be borrowers on the same terms, given differences in risks and administrative costs in handling different sized loans. Discrimination can be said to exist only if (1) loan differentials between borrowers are more than sufficient to compensate for differences in risk and handling costs, or (2) if credit is rationed by non-price means differently among borrowers. There is little empirical evidence that a capital "gap" in the first sense exists. As for discrimination in the second sense, given institutional constraints such as usury laws, and generally sluggish adjustment of credit terms in response to changing economic conditions, credit rationing is very likely to occur. In a tight money period, one would expect higher interest rates, tighter terms and/or credit rationing for all would-be borrowers.

A recent study examined the complaint that small businesses are being discriminated against by the banks in Canada. The

study involved an examination of 2,250 loan application files in the chartered banks and questionnaire survey of nearly 400 small business in Canada. In addition, 50 small businesses were contacted after the receipt of their questionnaire to further investigate the problem areas. The loans were compared on five dimensions: rejection frequency, amount of loan granted versus requested, interest rate, collateral requirements and term of the loan or repayment period. A major finding of this study was

> that the banks do not treat smaller businesses in a substantially different fashion from larger firms, especially considering the difference in risk and the cost of administering these loans. However,... the banks are perhaps being overly conservative in certain areas, such as collateral requirements, and are perhaps rejecting many bankable loans without ever considering these loans in detail (Knight, 1982)..

The "conservative and excessive collateral" arguments are open to question because of the findings of another background study dealing with small business/bank relationship. It was noted that:

> Most of the respondents whose loan applications had been turned down reported that the reason given was a lack of security or uncertain profit prospects. Very few reported that they were turned down becuase of questionable management ability. The loan application files, however, list insufficient management skills as the major reason for a loan decline (An Overview of Small Business Financing, 1982, p. 27).

Nonetheless, this study concludes that the general treatment accorded small business is comparable to that extended big business by the banks.

> Small businesses, in fact, receive more favourable treatment by the banks in terms of the amount of financing obtained relative to the amount requested, the covenants and information demands imposed on the business and the time taken by the banks to reach a loan decision. Two major differences that can possibly be considered as unfavourable to small business are higher interest rates paid on loans and the banks' insistence on personal guarantees and personal collateral from the principals in a small firm. The higher loan rates seem to be justified by the additional administrative costs (on a per dollar basis) in lending to small firms. The collateral difference seems to result from the characteristic that bankers would attribute as being most unique to small businesses, namely, the fundamental importance of the owner/operator in shaping the company's success (An Overview of Small Business Financing, 1982, p. 40).

Federal and provincial governments have recognized that conventional financing sources are often too conservative to finance the projects of many entrepreneurs, particularly the high technology-based ventures. As a result they have established a number of alternative financing vehicles such as the Federal Business Development Bank and the Small Business Loans Act. Many small businesses are often not in a position to take advantage of these sources because they lack the expertise and resources required to prepare comprehensive plans and financial package proposals.

Another major problem with much of the debt financing offered by governments is that it normally must be secured.

This has severe implications for small firms which have grown and which need funds for expansion. "In spite of government's best efforts they [small growth firms] are unlikely to attract long-term debt since they cannot offer enough security. The answer seems to be equity from the private investor" (Dunbar, 1980, p. 4).

Problems related to marketing and finance are especially significant for small high technology based ventures. In a recent study of innovation and technological change processes in five Canadian industries, the following issues in respect of the small firm were identified: technical difficulties were cited less often as a major problem in developing their innovations, than those related to marketing and finance.

> Unlike large firms which in general, have had little difficulty financing their major innovations, reliance on internally generated funds by small firms appears to reflect difficulties in obtaining funds externally... The government is an important source of external funds for part of the funding of the innovations of small firms which were funded externally...Nevertheless, many small firms stressed in our interviews that they lacked the resources necessary to do the planning and financial analysis required by governments which would allow them to take full advantage of government funding programs (De Melto, McMullen and Wills, 1980, p. 266).

Entrepreneurs have tended to associate initial equity participation by venture capitalists with control or even "takeover". With this perspective we might note the complaints voiced by some entrepreneurs. Where complaints were voiced about venture capitalists they were with regard to equity and management participation, or the "unfavourable" terms on which the venture capital had to be obtained.

A venture capital background study for the Small Business Financing Review Team noted that:

> Small businessmen know little about venture capital financing, and what they think they know is often inaccurate...Small businessmen are often irrationally hostile toward venture capital financing because they believe it means giving up control of their enterprises (Thorne Riddell, 1981, p. 9).

Equity participation and higher rates are an integral part of the venture capital business. It is not evident that they are being "unfair". One might speculate that where Canadian entrepreneurs are dissatisfied with venture capital, it is, at least in part, a reflection of their: (a) misunderstanding of what "venture capitalists" are about, and (b) underestimation of the riskiness they represent as an investment.

4.2.5 MARKETING

Marketing is a key problem area for many small businesses, not least of all for technology-based organizations (De Melto, McMullen and Wills, 1980). In one study of PAIT failures, the marketing category emerged as the main problem area (Fingarson and Kyle, 1972). Unsubstantiated estimates of sales growth, market penetration, user requirements, transportation costs, service networks, tariffs and trade policies were common place. Some companies undertook development of relatively conventional products with little examination of global supply and demand forecasts for the near future. Others overlooked critical marketing costs in their calculations.

Similar marketing problems were uncovered in another study involving technology-based firms, most of whom were recipients of government grants (Litvak and Maule, 1974, p. 47). The marketing performance of many of these small firms was weak, and was a major factor for the apparent inability of these firms

to be more profitable, and thus more viable. Their product-service lines were often limited (narrow) and in the case of technically-based operations, the owner-managers frequently were unable to see the linkage between production innovation and marketing innovation, i.e., that technical innovation through product modification could be successful only if the benefits were readily perceived by the intended users.

Some of the new product development was carried out and implemented before any attempt was made to assess the market potential and the costs of penetrating the market. Over-estimating demand, under-estimating competition, ignoring the need to invest in promotion, selection of inefficient and costly distributors, over-extension of credit through consignment selling, understaffed sales organization, inadequate warehousing facilities and unreliable delivery and service support were some of the reasons deduced for the problems encountered by the firms.

Another major problem arose from under-estimating user needs and post sales service demands. Key costs were ignored in this area including those related to the need for expanding company facilities, and personnel and customer training in order to service both product and customer requirements. The capital outlays required to service the "projected innovations" in the marketplace were in a number of instances the last obstacle to drive some firms into a premature exit.

On the general subject of small business in manufacturing,

> when small businesses do enter the manufacturing sector, their products often tend to be based on narrow skills, and an undifferentiated and abbreviated mix. Since they do not serve diverse markets with numerous products, they cannot average out ups and downs in the marketplace. Their products also tend to be more susceptible than those of larger firms to obsolescence, technological change, and the vicissitudes of consumer preference (Chandran, DeSavia and Young, 1977, p. 31).

The problems experienced on the selling side are frequently compounded by the problems encountered on the buying side. In recent years, at varying times, small firms have found themselves faced with shortages of raw materials, parts, and energy related products. The securing of suitable supplies of materials was a major headache for many small firms. Small-scale entrepreneurs have little leverage with suppliers since their requirements are relatively small, and they are thus obliged to pay higher prices. This is most evident in a period of rising prices or of material shortages, when suppliers are in a position to obtain premium prices from the smaller buyers (Levitsky, 1981).

> Many of the merchandising problems facing the small firm stem directly or indirectly from its size. As has often been noted, the larger corporation obtains purchase discounts because of its order volume, and maintains a storage capacity which enables it to carry the large inventory level needed to meet production and/or market demand. The small firm not only lacks this advantage but also may suffer from other size-related disadvantages of a more subtle nature. For example, it typically does not compile production cost data of the type and quality needed for pricing its products on an economically sound basis. It also tends to rely upon a restricted number of suppliers and customers as its main sources of procurement and sales, thereby further decreasing its competitive merchandising power (Said and Hughey, 1977, p. 40).

In the retailing and service areas, faulty location and

lack of definition of the real market were two of the key causes for the difficulties encountered by many small businesses. Rigidities associated with the management style of many owner-managers was in no small measure responsible for many of their marketing problems. Their lack of marketing skills is in some instances a greater handicap than the financial constraints under which they labour.

Current difficulties encountered by many small businesses in Canada tend to confirm some of the foregoing findings. In the case of the Halifax retail operation it was noted that,

> Although Goldberg's traditional reputation was built more on personal service than low price, Jon Goldberg wanted to compete head-to-head with national chains on price as well. He couldn't. The chains used their centralized administration and purchasing to get the best bargains on supplies, and their size and financial clout to get better deals on shopping centre leases. To make things even worse, some of Goldberg's shopping centre locations turned out to be commercial dogs. He wound up carrying far too much inventory for too long. As a result his stores began losing hundreds of thousands of dollars (Kimber, 1982, p. 27).

Although location is not a guarantee of success, poor location can go a long way toward precluding success (Kennedy, Loutzenhiser and Chaney, 1979).

Although failure may always be blamed ultimately on endogenous factors, exogenous factors are often present as well. Exogenous causes are of two kinds; first, there are causes unique to individual firms or industries--for example, the large chain store opening across from the small grocery; second, there are circumstances which affect business in general--recession, tight credit conditions or regional economic decline.

Evidence that the first type is quantitatively important to failure is scarce, although it obviously plays a role in individual situations. On the other hand, the effect of general recession on failure rates is well documented. In cyclical downturns, the "marginal" firm is more likely to fail.

In brief, most small firms in the manufacturing and service sectors tend to concentrate in a narrow product or service area. Thus, if factors external to the firm produce rapid changes in the technology of the product or buying preferences in the market, these firms are often ill-equipped financially and managerially to cope with such drastic developments. Their inability to read early warning signals simply compounds their marketing problems. For example, small scale

> manufacturers can seldom offer a full line of products which the retailers demand and the chains dictate terms of supply and even product specifications. Examples are hardware, building supply and auto accessory stores. Service firms face increased competition from chains, including franchises and a greater proportion of retail sales each year is purchased from chain stores, including variety store chains, once the traditional domain of the ma and pa store (Knight, 1981, p. 23).

4.2.6 Regulation

Small and medium sized firms encounter great difficulty in raising adequate capital at an affordable cost. They normally require more long term capital than they are able to raise under acceptable conditions. On average small and medium sized high technology firms need 75 percent more equity than they currently have to maintain adequate working capital and reasonable debt-to-

equity ratios (Johnston, 1980, p. 37).

It has been alleged that "many owner-managers dream of 'going public' with their company". In a recent interview, the chairman of the Ontario Securities Commission noted that,

> ...current rules and practices in Ontario prevent small businessmen from raising small amounts of capital from the public. This hinders development of new Canadian businesses. The law requires anyone issuing shares to the public to produce what usually is a costly and lengthy prospectus to disclose fully, honestly and plainly all material aspects of a proposed venture. People interested in going to the market for small amounts--say, about $1 million--find they cannot afford the disclosure costs.
>
> Stock firms cannot get enough profit from dealing in these smaller distributions, because the costs are higher than their return...(Willoughby, 1980, p. B-1).

The experience of many small Canadian firms parallels the foregoing observation. Besides failing to generate the expected financing, the firms were now required to disclose information which they felt was confidential, and in some cases too costly to develop and obtain. The cost of compliance was viewed as a nuisance and a misallocation of scarce resources. The disappointing financing performance of the new issue, and the loss of some control that accompanied it, made the "going public" experience less than a satisfactory one for some of the firms, regardless of their subsequent commercial performance.

The burden of regulation does not generally discriminate between large and small firms. However, since many of the costs are flat fees (i.e., listing and sustaining fee) regardless of size, this works to the disadvantage of small firms. There is the "exempt" category into which some smaller firms fall and in

this classification the firms are relieved of some of the reporting requirements. The Exchange watches over these firms and moderates their activities in an effort to ensure that everything is done in the best interests of the shareholders. However, junior industrials are never in the "exempt" category due to the listing requirements for these firms. Firms which may be exempt are mining, oil and gas companies. Thus, junior industrials are burdened with the same regulations as larger industrials.

"Business is being crushed by regulations" has been a major topic of debate in business-government relations in the 1970's. On the subject of "the impact of regulatory programs and paperwork on small business", the Canadian Federation of Independent Business (CFIB) noted that,

> the burden of these costs borne by small business is inequitable. Regulation imposes costs and requirements that large companies have the resources to meet but which often pose formidable hurdles for small firms. The accounting department of large firms are a cost of doing business that is easily passed on to the consumer. In Mom and Pop operations, Mom and Pop burn the midnight oil to get it done with little or no compensation. They can't pass on the costs to their customers, because they are not price leaders and because many of their prices are established by their suppliers (CFIB, October 16, 1979, p. 6).

While the CFIB has been successful in lobbying the government to reduce some of the required paperwork regulations, the findings of a recent Economic Council of Canada study indicates that small business is not being crushed by regulation (Peterson and Peterson, 1981). Most of the firms interviewed had fewer than five employees, and were ignorant of, or had limited

knowledge pertaining to, existing regulations. In sum, it was hypothesized that complaints voiced by small business pertaining to government regulations is probably a reflection of the general distaste that small independent business has for any government interference, particularly that which is accompanied by the drudgery of paperwork.

The problems of financing and regulation appear to be significant for small business in mining. Although little has been written on this topic, there is agreement among those who have, when it comes to identifying the problems that affect the operations of small firms in this industry. In a working paper on "the importance and viability of smaller mineral enterprises (SMEs) in Canada, the author defined the SME in Canada

> as a company or individual spending on average, less than $1,000,000 per year on activity which is directed to bringing forth new mineral supply. Each SME is headed by an entrepreneur who takes prime responsibility for the survival and growth of the enterprise (Freyman, 1979, p. 2).

The SMEs include independent smaller hard rock mining companies, independent non-producing mineral companies which either conduct mineral exploration or are dormant, and unincorporated individuals who pursue mineral exploration opportunities.

> (i) Over-regulation in the securities business: concern over potential fraudulent promotions caused regulatory authorities in Ontario and Quebec to regulate the junior exploration companies virtually out of existence...
>
> (v) Disincentives for foreign investment: FIRA regulations have discouraged foreign firms from investing in junior companies. Foreign companies now tend to operate through joint ventures with various Crown corporations, instead of with the junior companies...

(ix) Environmental and safety regulations in Canada are among the most stringent in the world, and add significantly to capital and operating costs...

(x) High interest rates in Canada for companies borrowing money for new developments render many potential mines uneconomic (Thompson, 1979, pp. 27-28).

One approach suggested for reducing the impact of these problems would have federal and provincial governments reverse the trend of excessive government regulation, coupled with tax structure changes so that the high risk and the social desirability of small mineral exploration is better recognized and rewarded (Government of Ontario, 1978). Small firms which have experienced some success in recent years, in spite of organizational and environmental obstacles, are those whose entrepreneurs and managers were willing to forego some management control by entering into joint ventures or option proposals with large firms as a means of financing their ventures and operations.

4.3 CANADIAN FEDERATION OF INDEPENDENT BUSINESS

An understanding of the key personality traits of the entrepreneurs/owner-managers of small businesses is necessary in order to appreciate the rationale and significance of their perception of the problems facing their businesses in Canada. The preceding section highlighted these traits and problems as documented in the small business literature. The following section will examine the problems faced by small business as

surveyed by the largest association of such firms in Canada, and chief spokesman for small business regarding competition policy in Canada. This discussion is a pre-condition for outlining those small business problems which are appropriate areas for research on competition policy.

The key spokesman for small business in Canada is the Canadian Federation of Independent Business (CFIB). In December of 1980, this association had a membership of 56,246 - Table 4-5. Less than 2 percent of the member firms had more than 100 employees, while 95 percent had fewer than 50 employees. In terms of annual sales, approximately 80 percent of the members had gross sales of less than $1,000,000 a year. The average sales and number of employees for the membership was $278,000 and 13.5 respectively.

Approximately 70 percent of the member firms were incorporated, 24 percent were proprietorships and the remaining 6 percent were partnerships. As for their geographic location, 41 percent were in Central Canada (Ontario), 30 percent in the West, 21 percent in Eastern Canada (Quebec), and the remaining 8 percent were situated in the Atlantic and such remote areas as the Yukon and North West Territories. The sector specific breakout of the membership was as follows (in rank order as a percent of total):

TABLE 4-5

MEMBERSHIP DATA OF THE CANADIAN FEDERATION OF INDEPENDENT BUSINESS, 1980

	B.C.	Alta.	Sask.	Man.	Ont.	Que.	PEI	NS	NB	Nfld.	Yukon	NWT	Canada
No. of Members	5381	5319	3423	2295	25705	9299	261	1533	1619	1094	164	155	56246
No. Emp. 1 - 4	37.26	32.76	43.52	38.38	41.51	54.79	31.03	34.18	42.12	41.04	34.75	37.25	42.20
5 - 9	28.39	28.89	30.96	29.67	27.28	20.91	33.71	30.52	28.04	26.59	21.34	33.98	26.94
10 - 14	11.54	12.65	9.81	10.19	10.79	8.38	13.02	11.80	9.57	11.51	15.85	9.80	10.58
15 - 49	17.65	19.10	13.23	16.29	15.45	11.64	19.54	18.39	15.75	14.71	18.90	16.99	15.38
50 - 99	3.30	3.83	1.63	3.22	2.90	2.80	1.91	3.65	2.53	3.47	7.31	1.30	2.97
Over 100	1.83	2.74	.81	2.22	2.03	1.45	.76	1.43	1.97	2.65	1.82	.65	1.90
Avg. No. Emp.	13.80	17.50	9.60	14.40	13.80	11.10	12.00	13.70	13.60	15.10	14.90	10.40	13.50
No.Yrs.Bus. 1 - 2	11.35	12.52	12.79	5.53	10.69	20.12	6.89	7.04	14.94	13.80	8.53	8.49	12.45
3 - 5	20.75	20.09	20.74	16.20	17.39	21.73	16.85	16.30	20.13	21.48	22.56	25.49	19.00
6 - 10	26.83	25.17	20.39	24.53	22.50	21.73	22.22	20.48	23.59	23.76	27.43	28.75	23.02
Over 11	41.05	42.20	46.07	53.72	49.41	36.41	54.02	56.16	41.32	40.95	41.46	37.25	45.50
Avg. Yrs. Bus.	12.30	12.00	13.20	14.90	15.20	10.80	16.20	18.10	11.60	14.90	11.70	10.00	13.70
Gr.Sales 1 - 20	.81	.80	.46	1.14	2.35	4.23	.00	.58	4.42	1.38	.00	.65	2.19
($000) 20 - 49	4.68	3.36	4.57	6.01	6.78	10.89	2.42	5.47	6.60	5.97	4.34	3.26	6.73
50 - 99	11.18	10.35	12.30	11.74	13.35	15.25	14.20	13.50	17.34	13.54	10.56	5.88	13.23
100 - 199	18.46	17.82	22.04	20.33	20.81	19.53	21.92	24.72	23.70	17.33	19.27	23.32	20.42
200 - 499	24.05	22.03	27.01	24.19	22.59	21.74	26.39	24.78	21.70	24.50	21.76	28.75	23.14
500 - 999	16.34	16.06	13.94	13.01	13.98	11.16	13.39	11.48	10.41	15.64	13.67	18.30	13.85
Over 999	23.58	28.89	19.12	23.49	19.07	16.21	20.71	18.72	15.15	20.51	29.84	19.60	20.21
Avg. Sales ($'000)	333.30	360.50	295.80	313.10	257.50	212.10	286.20	290.00	212.10	250.70	357.00	350.00	278.10
Proprietorship	10.61	8.81	18.34	19.21	22.38	45.48	21.07	23.35	25.20	26.50	7.92	8.49	23.51
Partnership	3.97	2.63	5.84	5.18	8.09	3.63	4.21	2.28	1.66	3.10	6.70	3.26	5.71
Corporation	85.11	88.17	74.11	74.90	69.11	50.75	74.71	74.03	72.82	69.92	85.36	88.23	70.33
Other	.29	.35	1.63	.69	.41	.09	.00	.32	.24	.45	.00	.00	.41
Agr.Forest.,Fish.	1.67	1.82	1.72	2.22	2.17	1.04	8.81	5.21	.80	1.00	.00	.00	1.92
Mining	.27	5.15	.17	.26	.15	.12	.00	.13	.06	.18	3.04	.65	.64
Construction	7.93	11.12	7.30	8.49	7.25	7.36	5.74	6.13	10.56	7.03	12.19	13.07	7.84
Man.&Processing	15.10	11.48	8.15	11.06	16.19	16.05	6.51	9.00	8.58	6.48	2.43	7.18	14.20
Trans.&Pub.Util.	2.99	3.17	1.92	2.30	2.19	2.79	1.53	2.34	1.05	2.74	7.31	16.33	2.48
Wholesale	9.16	8.47	8.91	9.97	8.48	6.40	7.66	6.00	3.76	6.85	2.43	3.92	8.02
Retail	33.76	26.58	42.12	36.94	29.64	38.28	40.22	48.46	45.83	51.09	37.19	31.37	33.70
Fin.,Ins.,Realty	4.99	6.24	4.82	5.09	5.49	1.93	4.21	4.17	4.87	3.38	5.48	2.61	4.76
Services	24.08	25.92	24.80	23.61	28.41	25.97	25.28	18.52	24.39	21.20	29.87	24.83	26.39

SOURCE: Canadian Federation of Independent Business

Retail	33.7
Services	26.4
Manufacturing	14.2
Wholesale	8.0
Construction	7.8
Finance, Insurance, Real Estate	4.8
Transportation and Public Utilities	2.5
Agriculture, Forestry, Fishing	2.0
Mining	.6

About 73 percent of the membership is in the tertiary sector, a figure higher than the national one, but consistent with the expectation that small firms tend to gravitate to business fields where the barriers to entry are low.

This backdrop to the membership helps place in perspective the various surveys that are aimed at identifying the major problems faced by small business. The information collected then becomes an important component of the CFIB's lobbying efforts with all levels of government, political and bureaucratic. It should be recognised that when CFIB was formed

> in the summer of 1971, the initial structures were established for a political action body, dedicated to challenging any concentration of unhealthy power in Canada...whether manifest in big government, big business or big labour (CFIB, 1981, p. 4).

Upon renewing their membership, CFIB field representatives interview the members concerning their view of the most important problems facing their business at that time. Ten such surveys have been conducted to date.[1] The results for

[1]The data for Survey No. 1 are not available.

surveys 2-10 are listed in Table 4-6. Over the years, conditions within the Canadian economy have changed the ranking of "the most important problem". In the most recent survey, covering the period January to September 1981, the membership voiced their concerns over the problems of high interest rates, inflation, labour, slower business and government regulation. Problems such as competition from large firms, tax burden, high wage rates and financing were perceived to be of relatively little importance (Table 4-7).

1. High Interest Rates

Since October 1979 financing, and since April 1980 high interest rates have been the most important problem areas for CFIB members. For the period January to September 1981, 39.7% of 28,598 members reported that high interest rates were their greatest concern (Table 4-8), while 19.2% stated that the level of interest rates was the second most important problem facing small business (Table 4-9).

In 1980, interviews were held with 10,864 CFIB members on the effects of high interest rates. The key findings were as follows (Bennett,1982): first, over 54% of all businesses interviewed had experienced a reduction in profits, and more than 17% had curtailed planned expansion. Second, firms which had been in business for more than 10 years felt high interest rates least; firms in operation for less than 2 years had the largest reduction in profits (61.5%). Those firms between 5 and 10 years in business showed the biggest curtailment of planned expansion

TABLE 4-6

CFIB SURVEYS: THE MOST IMPORTANT PROBLEMS

Percentage Distribution of Responses in the National Surveys

National Survey	1	2	3	4	5	6	7	8	9	10
Period Covered		3 Q 1975	2&3 Q 1976	4Q 1976 1 & 2 Q 1977	4Q 1977 1 & 2 Q 1978	3 & 4Q 1978	1 & 2 & 3 Q 1979	4Q 1979	3 & 4Q 1980	1 & 2Q 1981
No. of Reports		3,378	14,124	18,345	12,314	18,034	27,497	5,208	21,355	15,073
Government Regulations and Paperwork		18.2	23.0	11.9	13.3	11.3	15.4	8.3	8.8	7.5
Availability of Funds: Financing		9.2	8.4	--	8.1	10.6	17.0	22.7	4.9	2.9
High Interest Rates		--	--	--	--	--	--	--	22.7	36.6
Financing, Interest Rates		--	--	18.2	--	--	--	--	--	--
Taxes		5.3	7.6	10.1	21.5	10.3	7.2	5.7	5.5	4.8
Inflation		15.3	21.9	19.1	--	23.0	15.5	15.3	11.5	11.4
Cost of Labour, Minimum Wages		7.1	7.2	6.0	6.4	5.0	3.8	5.4	4.3	2.9
Availability of Competent Help		19.2	15.3	16.4	11.4	17.3	13.5	17.4	14.6	10.1
Employee Attitudes to Work		--	--	--	--	--	4.3	--	--	--
Competition from Large Business		5.3	10.5	--	7.7	5.1	--	8.1	6.7	4.9
Competition from Government		--	--	--	2.3	--	--	--	--	--
Competition from Large Business and/or Government		--	--	7.7	--	--	--	--	--	--
Business Slower Than Normal		--	--	--	14.1	7.4	8.8	5.5	11.8	9.2

TABLE 4-6 cont'd.

THE MOST IMPORTANT PROBLEMS

Percentage Distribution of Responses in the National Surveys

National Survey	1	2	3	4	5	6	7	8	9	10
Period Covered		3 Q 1975	2&3 Q 1976	4Q 1976 1 & 2 Q 1977	4Q 1977 1 & 2 Q 1978	3 & 4Q 1978	1 & 2 & 3 Q 1979	4Q 1979	3 & 4Q 1980	1 & 2Q 1981
No. of Reports		3,378	14,124	18,345	12,314	18,034	27,497	5,208	21,355	15,073
Strikes		--	--	--	2.5	--	--	--	--	--
Unions		2.0	--	--	--	--	--	--	--	--
Unreliability of Essential Public Services		--	--	--	--	--	4.1	--	--	--
Management "Know-How"		--	--	--	--	--	--	--	--	--
Shortages in Commodities or Goods		5.5	--	--	--	--	--	0.8	--	--

SOURCE: CFIB

CANADIAN FEDERATION OF INDEPENDENT BUSINESS
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TABLE 4-7

JANUARY - SEPTEMBER 1981
TABLE 1: NEW BY 06

CFIB: FIRST MOST IMPORTANT PROBLEM BY NUMBER OF EMPLOYEES, 1981

CANADA RESULTS
QUESTION SIX
WHAT IS THE FIRST MOST IMPORTANT PROBLEM YOUR BUSINESS IS FACING TODAY?

	NATIONAL RESULTS	NUMBER OF EMPLOYEES 1-4	5-9	10-14	15-49	50-99	100 +
NUMBER OF RESPONSES	28598.0	10429.0	8084.0	3528.0	4893.0	935.0	613.0
(1) HIGH WAGE RATES/WAGES	2.8	2.1	3.0	3.4	3.4	3.0	3.4
(2) COMPETITION	4.5	6.2	4.6	3.7	2.4	.9	1.6
(3) LABOUR	9.3	5.3	9.9	11.3	13.4	16.0	18.8
(4) SLOWER BUSINESS	8.1	10.1	7.3	7.2	6.5	5.9	7.2
(5) HIGH INTEREST RATES	39.7	38.2	40.2	41.1	41.5	43.4	32.3
(6) FINANCING	2.5	2.7	2.6	2.5	2.3	1.8	1.8
(7) INFLATION	10.1	11.8	10.7	8.4	8.0	7.0	7.8
(8) TAX-BURDEN	4.2	4.7	3.9	3.9	3.9	4.7	3.4
(9) GOVERNMENT REGULATIONS	7.0	7.2	6.8	6.9	6.9	6.6	8.2
(10) OTHER	11.8	11.9	10.8	11.9	11.9	10.7	10.4

CANADIAN FEDERATION OF INDEPENDENT BUSINESS
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TABLE 4-8

JANUARY - SEPTEMBER 1981
TABLE 25: SECTR BY CD

CFIB: FIRST MOST IMPORTANT PROBLEM BY TYPE OF ACTIVITY, 1981

CANADA RESULTS
QUESTION SIX
WHAT IS THE FIRST MOST IMPORTANT PROBLEM YOUR BUSINESS IS FACING TODAY?

	NATIONAL RESULTS	TYPE OF ACTIVITY AGRI FOREST FISHING	MINING OIL GAS	CONSTRUCTION	MANUFACTURE AND PROCESSING	TRANSPORT PUBLIC UTILITIES	WHOLESALE TRADE	RETAIL TRADE	FINANCE INSURANCE REAL ESTATE	SERVICE	OTHER
NUMBER OF RESPONSES	28598.0	542.0	265.0	2229.0	3970.0	623.0	2025.0	9982.0	944.0	7706.0	306.0
(1) HIGH WAGE RATES/WAGES	2.8	3.1	2.6	3.5	2.7	2.6	2.1	2.8	2.0	3.0	2.6
(2) COMPETITION	4.5	3.1	.4	3.5	2.5	3.5	3.6	6.9	6.3	3.2	3.6
(3) LABOUR	9.3	5.9	9.4	11.4	16.9	7.5	7.1	5.9	5.9	10.7	7.8
(4) SLOWER BUSINESS	8.1	3.7	8.7	13.6	7.8	6.7	7.6	8.4	3.6	7.5	5.9
(5) HIGH INTEREST RATES	39.7	50.7	18.5	41.0	35.5	37.1	42.2	45.3	38.9	34.1	31.4
(6) FINANCING	2.5	1.5	1.5	2.2	4.0	2.9	2.5	2.0	2.5	2.7	15.0
(7) INFLATION	10.1	11.8	4.9	5.1	7.8	9.0	6.9	10.4	13.2	12.7	6.2
(8) TAX-BURDEN	4.2	2.8	4.9	2.6	3.4	2.7	3.6	4.1	4.3	5.5	4.6
(9) GOVERNMENT REGULATIONS	7.0	5.7	10.9	6.6	6.4	11.2	7.1	5.5	8.6	6.7	6.2
(10) OTHER	11.8	11.6	38.1	10.6	13.0	16.7	15.0	8.8	14.6	12.0	28.4

CANADIAN FEDERATION OF INDEPENDENT BUSINESS
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TABLE 4-9

JANUARY - SEPTEMBER 1981
TABLE 2a: SECTR BY 07

CFIB SURVEY: SECOND MOST IMPORTANT PROBLEM BY TYPE OF ACTIVITY, 1981

CANADA RESULTS
QUESTION SEVEN
WHAT IS THE SECOND MOST IMPORTANT PROBLEM YOUR BUSINESS IS FACING TODAY?

	NATIONAL RESULTS	TYPE OF ACTIVITY: AGRI FOREST FISHING	MINING OIL GAS	CONSTRUCTION	MANUFACTURE AND PROCESSING	TRANSPORT PUBLIC UTILITIES	WHOLESALE TRADE	RETAIL TRADE	FINANCE INSURANCE REAL ESTATE	SERVICE	OTHER
NUMBER OF RESPONSES	28598.0	542.0	265.0	2229.0	3970.0	623.0	2025.0	9982.0	944.0	7700.0	306.0
(1) HIGH WAGE RATES/WAGES	3.4	3.0	1.5	4.1	3.2	3.4	3.2	3.4	2.4	3.0	2.0
(2) COMPETITION	4.2	3.3	2.3	2.0	3.3	1.9	4.0	5.0	5.5	3.3	3.3
(3) LABOUR	8.0	5.0	7.5	11.1	11.8	5.8	7.0	6.5	5.5	7.9	7.8
(4) SLOWER BUSINESS	5.8	4.4	11.3	8.7	4.8	5.1	5.8	6.5	4.7	4.8	4.9
(5) HIGH INTEREST RATES	19.2	18.3	22.3	23.0	20.2	24.4	19.2	18.7	16.3	18.4	12.7
(6) FINANCING	5.1	5.9	2.3	4.5	5.2	3.2	6.1	5.1	5.7	5.1	5.2
(7) INFLATION	16.1	21.0	15.8	12.7	13.0	14.9	14.2	18.4	18.4	18.2	10.8
(8) TAX-BURDEN	8.9	7.0	6.4	6.3	7.9	7.1	8.7	9.1	9.1	10.2	6.2
(9) GOVERNMENT REGULATIONS	12.0	16.2	15.1	10.8	10.8	17.7	12.6	11.0	13.6	12.9	11.4
(10) OTHER	17.4	15.9	15.5	15.5	19.8	16.5	19.1	15.7	20.8	17.5	35.0

(19.5%). CFIB found these results particularly distressing because it meant that there would probably be a further increase in business failures among the very young enterprises, and also that the normal growth of firms that had survived the first five years would not take place.

Third, the negative impact on expansion had more serious implications when results by size were studied. The very smallest businesses, those with 1-4 employees, seemed to be weathering the interest rate squeeze best, since 22.4% of the firms in this category said high interest rates had no significant effect. The problems with interest rates increased with the size of the firms: between 15-49 employees, there was a 56.2% reduction in profits; 50-99 employees, a 59.1% reduction; 100 and more employees, a 61.1% reduction. For the same population of firms, figures for curtailing expansion were: 20.2%, 21.6% and 22.5% respectively. Thus, businesses approaching medium-size were being hurt the most.

2. Inflation

For 10.1% of the 28,598 respondents inflation was found to be the "first most important problem facing business". Although inflation puts the squeeze on all businesses regardless of size or industry, small firms have a limited ability to absorb the impact of increasing costs and prices. During inflationary times, sales drop, inventories accumulate and small firms are forced to borrow at higher interest rates to support themselves.

At the same time, employee wages escalate to meet the higher costs (Bennett, 1980).

Inflation impinges on the activities of small firms in two ways. On the cost side, the rising prices of raw materials and labour push the cost of operations up. Since small firms are often unable to match rising wage rates and fringe benefit demands, they are unable to retain or attract skilled labour. On the revenue side, small firms find it difficult to pass on increased costs in the form of increased prices because of elasticity of product demand. In a sense, the periphery where small businesses operate often resembles a highly competitive market. Unlike their larger counterparts, small firms often cannot easily change processes or update technology to minimize the effect of rising costs and decreased productivity, nor can they discontinue production of low markup items and shift to higher profit lines (Chandran, DeSalvia and Young, 1977).

3. Labour

For 9.3% of the respondents labour was the most critical problem, associated largely with recruiting, motivating and retaining competent workers.

4. Slower Business

"Slower business" was cited by 8.5% of the respondents. Small firms tend to be more vulnerable than large firms in an economic recession. The typical cycle for many marginally

profitable firms follows a common pattern in a recession. Since markets are depressed, there is a decline in sales, and consequently, cash flows and profits disappear. Cash and credit become difficult to obtain, and lacking cash or credit, these firms cannot purchase merchandise to manufacture or sell, and thus fold.

5. Government Regulations

Government regulations were cited by 7% of the respondents as the most important problem. As a result of complaints received from CFIB members regarding regulatory programmes and paperwork, the organization conducted a pilot project in conjunction with the provincial survey questionnaire in Spring 1979. Members were asked: "What provincial government forms and regulations bother you the most?" Responses covered all bases including: (1) record keeping requirements; (2) standards compliance; (3) overlapping or contraditory rules and regulations between the various ministries and jurisdictions; (4) inappropriate or obsolete regulations and reporting criteria; (5) forms that require excessive details, and are too complex; (6) the number, length and usefulness of surveys to be filled out; (7) several ministerial agencies asking for the same information; and (8) no provisions for review or appeal of regulatory requirements.

The findings concerning the real and perceived excessiveness of government regulatory programmes were as follows (CFIB,

October 16, 1979): first and foremost, it was expensive. There were enormous costs, both direct and indirect, associated with regulation and paper burden. For the small businessman, time was money. Every time he had to fill in a form, answer a questionnaire, calculate a sales tax return, or fill out a capital tax return, it ate into his time and profits and ultimately taxable revenues. Most members incurred extra costs to fill out forms and to figure out details of returns.

Second, the burden of the costs borne by small business was inequitable. Regulation imposed costs and requirements that larger companies had the resources to meet but which often posed formidable hurdles for small firms. The accounting department of large firms were a cost of doing business that was easily passed on to the consumer. Small businesses could not pass on the costs to their customers because they were not price leaders and because many of their prices were established by their suppliers. Third, many of the government regulatory programmes were duplicative, and the small businessman did not have the time to analyze whether he was subject to the regulations.

6. Big Business Competition

Between 1975-1981, the CFIB periodically altered the phrasing of the "competition question" in its national survey. Exhibit 4-1 is an example of the survey questionnaire. Depending on the year of the survey, the competition question has been phrased in one of the following ways:

CF 19
ISSUE NO

OUR MEMBERS' OPINIONS

NATIONAL SURVEY

CANADIAN FEDERATION OF INDEPENDENT BUSINESS

Our Members' Opinions is a very powerful communication tool. A computerized summary is presented regularly to the media and to federal and provincial governments. Your opinions remain confidential. We encourage you to discuss these current issues with your business associates. If you wish to comment further, space is provided on the back of this form.

INSTRUCTIONS: Please answer each question carefully. Check answer in pencil or ink.

BUSINESS INFORMATION

1. How many employees do you have (full or part-time including yourself)?
   (1) 1-4 (2) 5-9 (3) 10-14 (4) 15-49 (5) 50-99 (6) 100 and over — 1. [1] [2] [3] [4] [5] [6]

2. How long have you been in business?
   (1) less than 2 years (2) 2-4 years (3) 5-10 years (4) over 10 years — 2 [1] [2] [3] [4]

3. What is the form of your business organization?
   (1) Proprietorship (2) Partnership (3) Corporation (4) Other — 3 [1] PROPRIETORSHIP [2] PARTNERSHIP [3] CORPORATION [4] OTHER

4. Which ONE activity provides the greatest amount of your gross income?
   (1) Agriculture, Forestry, Fishing (2) Mining, oil and natural gas
   (3) Construction (4) Manufacturing & Processing
   (5) Transportation & Public Utilities (6) Wholesale Trade
   (7) Retail Trade (8) Finance, Insurance, Real Estate
   (9) Services (10) Other, not classified in one of above

   4. [1] AGRICULTURE, ETC. [2] MINING, OIL AND GAS [3] CONSTRUCTION [4] MANUFACTURING [5] TRANSPORTATION, ETC. [6] WHOLESALE [7] RETAIL [8] FINANCE, ETC. [9] SERVICES [10] NON-CLASSIFIABLE

5. Where is your business located? (Mark one)
   (Z) N.W.T. (Y) Yukon (B) B.C. (A) Alta.
   (S) Sask. (M) Man. (O) Ont. (Q) Que.
   (W) N.B. (V) N.S. (P) P.E.I. (N) Nfld.

   5 [Z] N.W.T. [Y] YUKON [B] B.C. [A] ALTA. [S] SASK. [M] MAN. [O] ONT. [Q] QUE. [W] N.B. [V] N.S. [P] P.E.I. [N] NFLD.

(Questions 1 to 5 must be answered to allow computer processing)

MOST IMPORTANT PROBLEM

6. What is the most important problem your business is facing today? (Mark one)

7. The second most important? (Mark one)
   (1) High wage rates
   (2) Competition from big business
   (3) Shortage of qualified labour
   (4) Business slower than normal
   (5) High interest rates
   (6) Availability of financing
   (7) Inflation
   (8) Total tax burden
   (9) Government regulation, red tape, paperwork
   (10) Other (Please specify)

6. FIRST MOST IMPORTANT	7. SECOND MOST IMPORTANT
[1]	[1]
[2]	[2]
[3]	[3]
[4]	[4]
[5]	[5]
[6]	[6]
[7]	[7]
[8]	[8]
[9]	[9]
[10]	[10]

MANPOWER

8. Which of the following is your most important problem in obtaining competent help? (Mark one)
   (1) Willingness to work (2) Availability of necessary skills
   (3) Level of wages (4) No problem

   8. [1] [2] [3] [4]

9. What is your most effective method of locating new employees. (Mark one)
   (1) Ad in local paper
   (2) Notice on your premises (window, bulletin board etc.)
   (3) Canada Employment Centre
   (4) Referred by your friends, employees, etc.
   (5) Professional employment service
   (6) Other (Please specify)

   9. [1] [2] [3] [4] [5] [6]

CREDIT AND COLLECTIONS

10. Do you provide goods and services on credit (exclude credit cards)?
    (1) Yes (2) No — 10. [1] [2]

11. If yes, in the last three months has collecting your accounts receivable been... (Mark one)
    (1) More of a problem (2) Less of a problem (3) Not a problem — 11. [1] [2] [3]

12. Have N.S.F. cheques been a problem for your business?
    (1) Yes (2) No — 12. [1] [2]

13. Approximately how many NSF cheques did your business receive in the last year? (Mark one)
    (1) None (2) Less than 10 (3) 11-25 (4) 26-50 (5) over 50 — 13. [1] [2] [3] [4] [5]

- "Competition from large business"
- "Unfair competition from large business"
- "Competition from big business"

Competition from big business was cited as the most important problem by only 4.5% of the respondents, and as the second most important problem by 4.2% of the respondents. Competition as a major problem diminishes with size of firms, with 6.2% of the firms with 1-4 employees, 4.6% of the firms with 5-9 employees, 3.7% of firms with 10-14 employees, and .9% of firms with 50-99 employees finding competition to be a major concern. The figure rises somewhat to 1.6% for firms with over 100 employees.

When it comes to the age of the firm, the perceived problem of competition decreases with age, from approximately 5.5% for those in business 0-4 years, and 4.3% for those operating for five years or more. And by "type of industry activity", the problem of competition received attention from the retail (6.9%) and financial (6.3%) sectors, while the mining-oil-gas sector found competition to be unimportant (0.4%).

7. Tax Burden

Tax burden was regarded as the most important problem by 4.2% of the respondents, and as the second most important problem by 8.9% of the respondents. It was generally felt that small business must receive additional special tax treatment; i.e., additional incentives were required to counterbalance the many

advantages realized by big business, which was largely capital intensive and was thus effectively subsidized through capital cost allowances, depletion allowances, deferred taxes and other concessions (Rosen, 1981).

8. Financing

Financing was viewed as the first most important problem by 2.5% of the respondents and as the second most important problem by 5.1% of the respondents.. Despite this low ranking there were many complaints concerning problems experienced by small business in their dealings with the chartered banks, which provided approximately 90% of all business loans. Lending policies were deemed to be too conservative and restrictive.

4.4 NATIONAL FEDERATION OF INDEPENDENT BUSINESS

The Canadian situation is comparable to the one faced by small business in the U.S. The CFIB counterpart in the U.S. is the National Federation of Independent Business (NFIB). The NFIB periodically conducts surveys over a random sample of its 550,000 small and independent member firms.[1] These surveys reflect the activities, actions, and views of all NFIB members given a $\pm$ 2.5 percentage point margin of error at the 95% confidence level (NFIB, 1979, p. 2).

[1] It is interesting to note that the U.S.-Canadian membership ratio is 10 to 1, the yardstick employed to draw economic comparisons between the two countries.

In its October 1981 survey of 2,223 member firms, interest rates and financing was judged to be the single most important problem facing small business in the U.S., as reported by 36% of the firms. Inflation ranked second, with 23% of all respondents citing this problem, while taxes ranked third, with 11% of respondents citing this factor. For 7% of the respondents inadequate demand for the product was a problem, with an equal number of firms citing competition from large business as a major problem. Quality of labour (4%), government regulation (4%) and cost of labour (3%) received only minor attention. Tables 4-10 to 4-12 present the breakdown of the 2,223 responses.

4.5 RELATIONS WITH BIG BUSINESS

Some thirty small business owners and executives serving the small business sector, from across Canada, met at the Niagara Institute, January 29th-31st, 1982 to review the state of small business in Canada and to make recommendations regarding its future.

The aims of the conference were:

> to develop a common understanding and general awareness of the determining factors and issues that will influence small business in the foreseeable future;
>
> definition of obstacles that prevent small business from reaching its full potential and "desirable figures" (The Niagara Institute, 1982).

Numerous internal and external factors which were likely to have a positive or negative impact on the small business sector over the next ten to twenty years were identified. Only two of the

TABLE 4-10: NFIB SURVEY: SINGLE MOST IMPORTANT PROBLEM FACING BUSINESS, 1980-1981

QUESTION: *What is the single most important problem facing your business today?*

MOST IMPORTANT PROBLEM	1980 JUL Rank	1980 JUL %	1980 OCT Rank	1980 OCT %	1981 JAN Rank	1981 JAN %	1981 APR Rank	1981 APR %	1981 JUL Rank	1981 JUL %	1981 OCT Rank	1981 OCT %
Taxes	1	18	3	15	3	16	3	18	3	15	3	11
Inflation	1	33	1	34	1	32	1	28	2	26	2	23
Inadequate Demand For Product	5	7	6	5	4	5	5	5	5	5	4	7
Interest Rates & Financing	3	15	2	19	2	25	2	25	1	31	1	36
Minimum Wage Laws Cost of Labor	8	3	6	3	7	4	8	3	9	3	8	3
Other Government Regulations, Red Tape	4	8	4	7	4	5	5	5	5	5	6	4
Competition from Large Business	6	5	4	7	4	5	4	6	5	5	4	7
Quality of Labor	6	5	7	4	8	3	5	5	8	4	6	4
Shortage of Fuels, Materials or Goods	9	1	9	1	9	1	9	*	*	*	9	*
Other, No Answer	-	5	-	5	-	4	-	5	4	6	-	5
Total	100%		100%		100%		100%		100%		100%	

*Less than 0.5%

TABLE 4-11: NFIB SURVEY: SINGLE MOST IMPORTANT PROBLEM BY TYPE OF INDUSTRY, 1980-1981

MOST IMPORTANT PROBLEM	INDUSTRY* Construction	Manufacturing	Transportation	Wholesale	Retail	Agriculture	Personal Services	Nonprofessional Services	Professional Services	ALL FIRMS†— OCT 1981
Taxes	10	13	*	8	11	9	7	18	16	11
Inflation	11	20	21	22	26	25	19	37	30	23
Inadequate Demand for Product	10	11	10	5	4	16	1	5	8	7
Interest Rates & Financing	51	30	42	42	35	28	48	18	23	36
Minimum Wage Laws, Cost of Labor	2	4	*	1	3	5	*	6	3	3
Other Government Regulations, Red Tape	5	4	10	5	1	2	7	5	8	4
Competition from Large Business	2	4	7	10	11	2	11	3	5	7
Quality of Labor	4	9	1	2	4	2	1	4	1	4
Shortage of Fuels, Materials or Goods	*	1	*	1	*	*	*	*	*	*
Other, No Answer	5	4	9	4	5	11	6	4	6	5
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Number of Firms	304	281	71	195	707	105	170	241	146	2223
Percent of Firms	14	13	3	9	32	4	8	11	6	

*See Table A-1 for a detailed description of these classifications
†Includes 3 firms for which no industrial classification was ascertained
*Less than 0.5%

SOURCE: National Federation of Independent Business.

TABLE 4-12: NFIB SURVEY: SINGLE MOST IMPORTANT PROBLEM BY SALES OF FIRM, 1980-1981

QUESTION: *What is the single most important problem facing your business today?*

	SALES OF FIRM*									
MOST IMPORTANT PROBLEM	Less than $30,000	$30,000–$99,999	$100,000–$199,999	$200,000–$349,999	$350,000–$749,999	$750,000–$1,499,999	$1,500,000–$2,999,999	$3,000,000 or more	Not Ascertained	ALL FIRMS–OCT 1981
Taxes	21	19	12	8	10	9	5	7	12	11
Inflation	24	23	26	27	26	19	21	19	16	23
Inadequate Demand for Product	8	6	6	8	6	5	7	7	4	7
Interest Rates & Financing	22	32	32	36	34	42	43	45	33	36
Minimum Wage Laws, Cost of Labor	3	5	2	3	3	4	2	3	4	3
Other Government Regulations, Red Tape	5	2	5	3	6	2	5	4	4	4
Competition from Large Business	9	7	9	7	4	7	6	6	12	7
Quality of Labor	1	2	2	2	5	6	7	6	3	4
Shortage of Fuels, Materials or Goods	*	*	*	*	*	1	*	*	*	*
Other; No Answer	7	4	6	6	6	5	4	3	12	5
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Number of Firms	203	248	339	321	380	265	176	240	51	2223
Percent of Firms	9	11	15	15	17	12	8	11	2	

*Quarter sales, or annual rates
†Less than 0.5%

SOURCE: National Federation of Independent Business.

many factors listed were related to the importance and prospective role of big business vis à vis small business: "a greater tendency toward distrust of big business and big government could result in increased acceptance of small business values"; and, "procurement by large corporations and governments is becoming increasingly more complex, and small business finds it increasingly more difficult to respond" (The Niagara Institute, 1982).

The participants acknowledged that the impact of government on the business community was great and diverse. Their concern was that the activities and actions of government might favour big business at the expense of small business. The consensus was that strong links between small and large enterprises were essential if Canada was to have a healthy small business sector; for example, "small business should be able to participate in major projects, provide local or specialized needs of large corporations and participate with large corporations in the development of Canada's natural resources" (The Niagara Institute, 1982).

A similar message to promote greater cooperation between big and small business was put forward by an official of the Small Business Secretariat.

> It is common belief among many in Canada that larger firms have an unbounded, voracious appetite to consume, or to force out of business, smaller firms. While this happens, of course, the case is usually overstated. There is growing evidence, in fact, of a trend towards greater mutually beneficial cooperation between larger firms and small through mechanisms

> such as sub-contracting and private branding; franchising or licensing agencies; managerial cooperation and assistance; quality control; supplier payment agreements and industry productivity institutes. Examples which may be cited include the excellent specification buying program of Sears, Ltd., the aggressive sub-contracting policy of Xerox, Ltd., and the "open door" policy of Bata Shoe Ltd., whereby small shoe firms interested in learning in detail about Bata's operating procedures can walk into the plant, see evertyhing they want to see up to and including costs per unit incurred in various stages of the production process (Skelton, 1979, p. 2).

In 1980, a White House Conference on Small Business was held in Washington. Some 60 specific recommendations resulted from this conference, 15 of which were identified as top-priority measures requiring immediate attention.

> ...the single most important message of the Conference is that government must eliminate those obstacles and inequities and play a reduced role in small business activities.
>
> Eleven of the top 15 recommendations, for example, involve taxes, inflation, and regulation. Uppermost among the delegates' concerns is that disproportionately heavy taxes are siphoning away capital, and that misguided regulations and paperwork are siphoning away productive time and energy. The delegates are disturbed too, that only a tiny fraction of federal research and development dollars go to small, innovative firms. They want specific procurement and credit measures to help groups outside the economic mainstream to build businesses of their own. And they want channels opened so that small business interests can be advanced in policymaking circles (White House Committee, 1980, p. 13).

Competition with big business was not viewed as an overriding issue. If there was a concern in this general area it had to do with the role of big government. First, criticism was directed at excessive government regulations and paperwork which were viewed as more burdensome for small, than big business. Second, there were the added problems resulting

from government competition in the marketplace; namely, that government agencies were providing goods and services which could be better provided by the private sector, and in particular by small business (SBA, 1980).

These observations about competition are a far cry from what is normally identified as a major issue of concern by economists. Recognising the criticial role which small business plays in the U.S. economy, a Congressional sub-committee on Antitrust, Consumers and Employment held a series of hearings on the future of small business in the late 1970's. Every economist who testified before the sub-committee voiced concern over "the current galloping trends toward economic concentration and increased acquisitions and mergers as the problem facing small business in need of Congressional attention" (1978, p. 31).

A word of caution is in order. The exit or death of a small firm may take place through the sale of its assets to other firms, small or large, and this may be a desirable result, for this reason mergers should not be treated as synonymous with anti-competitive, industrially concentrating processes. Inefficiency, capacity and poor management can be eliminated or replaced via mergers, with minimal disruption to effective competition. On the other hand, not all mergers should be perceived as benign as far as market structure, behaviour and performance is concerned.

A sub-theme expressed by the Congressional Committee was

that big business was increasing its share of the nation's economic activity, at the expense of small business. Yet, according to a recent survey by the National Federation of Independent Business, competition was cited as the most important problem by only 4.5% of the respondents, and as the second most important problem by 4.2% of the respondents.

In an introduction to an article by Milton D. Stewart, the first Chief Counsel for Advocacy of the Small Business Administration, the editors of Antitrust Law and Economic Review stated that,

> Since it is a truism that "entry barriers" are the common enemy of both would-be entrepreneurs and the antitrust authorities, we hope--again as noted in our editorial Foreword, above--that our readers will get in touch with Mr. Stewart and contribute their expertise to his current research program. The possibility of seeing the small business establishment in America actually throwing its weight behind rather than against a sound anti-trust program is one that, however remote it might seem to the veterans of these wars, ought to be nurtured most carefully indeed. Most of us can only talk about what an ideal antitrust effort would look like; these several thousand small business leaders who are represented by Mr. Stewart could, we're assured, actually bring it to pass if they were persuaded that it would do nice things to their bottom lines. It would, of course, but then who--besides the industrial-organization pros in this inimitable audience--is equipped to prove it to them? (1979, pp. 68-69).

The fear of going public was identified as a key reason against documenting some of the commercial difficulties "deemed unfair" by small business in their dealings with "Government-Size" (Big) Business. Reflecting on his meetings with members of the U.S. small business community, M.D. Stewart noted,

> I have heard again and again in city after city the questions: 'Doesn't the government know that big companies are becoming harder and harder for us to deal with all the time? Doesn't it know how they automatically raise prices to us at the same time and in the same way?' Let me tell you candidly that these questions are asked quietly in corridors after meetings rather than from the floor. Small business people are often reluctant, to put it mildly, to talk about their experiences with large customers in public meetings (1979, p. 77).

This situation is not unique to the United States. For example, the Ontario Federation of Agriculture (OFA) in a brief to a Government of Ontario royal commission noted that,

> We knew from first hand experience how reluctant are food manufacturers and suppliers to bring forward the facts regarding their sales arrangements, particularly in regard to discounts and allowances... the most expedient way--in fact the only way--to uncover the facts and implications of these practices is to conduct informal confidential interviews and confidential conversations with persons in all sectors of the food manufacturing and supply industries. In our opinion and experience, if such firms are assured that their frank cooperation would be confidential to Commission personnel only, and assured that all or most firms will be approached in a similar manner, then cooperation will be readily forthcoming. In this way the staff can determine the nature of the bargaining situation and can discern the nature and trade of the competitive environment. The statistics and data showing such factors as market shares and price differentiation, important as they are, can never in themselves disclose the reality of control and influence and the actual operation and dynamics of commerce (February 1979, pp. 1-2).

These observations are significant for a number of reasons. First, they are not atypical to the Ontario Federation of Agriculture. Second, businessmen generally are reluctant to complain publically about unfair and anti-competitive practices involving their competitors. The explanation for this reluctance

is two-fold: ideological and the fear of economic retribution. The ideological reason centers on the belief that open competition - "no holds barred and minimum government intervention" - is essential to the workings of the capitalist system, and small business should be committed to this principle. Consequently, small business must not give government any additional excuse for greater intervention in the marketplace. The fear of economic retaliation arises from the concern that "snitching" on one's competitors, suppliers, or customers is potentially dangerous. Such actions may produce costly consequences for the complainant; for example, price intensive reactions from competitors, slower deliveries from suppliers, and buyer resistance from customers.

For these and similar reasons, the complainants typically demand confidentiality, will not document their grievances on paper, are reluctant to show their correspondence and files to government investigators, and are generally suspicious of any government organization or individual interested in putting forward or defending their position. On the other hand, when some of their "unfair trade" allegations are proven unfounded because of a lack of evidence, the tendency is to question the quality of the study, the lack of industry experience of the investigators, and generally to focus on the excessive "academic orientation" of the study's methodology, findings and recommendations.

4.5.1 Contractual Arrangements

The Canadian Small Business Secretariat noted the array of contractual arrangements which small firms have with larger firms such as franchising, licensing, agency and sub-contractual

agreements, which need not be mutually exclusive.

> ...a franchise involves primarily retail, service, or wholesale operations operated by one or several individuals. Franchise holders are independent businessmen--not employees, not agents and not contractors to the franchisor. In a broad sense, they do not operate as licensees. Current use of the word franchise seems always to involve geographic areas of operations... licensing is based upon patents, trademarks and industrial type technology and it relates generally to manufacturing processes or manufactured products, often in million dollar corporate endeavours. Thus, franchising can be said to be to the individual as licensing is to the corporation...(Brown, 1979, p. 3).

According to a U.S. government publication,

> Franchising is a form of licensing by which the owner (the franchisor) of a product, service or method obtains distribution through affiliated dealers (the franchisees). The holder of the right is often given exclusive access to a defined geographical area.
>
> The product, method or service being marketed is identified by a brand name and the franchisor maintains control over the marketing methods employed.
>
> In many cases the operation resembles that of a large chain with trademarks, uniform symbols, equipment, storefronts, and standardized services or products, and maintains uniform practices as outlined in the franchise agreement (U.S. Dept. of Commerce, 1979, p. xxiv).

As for the agency agreement,

> ...Typically, the goods would be shipped on consignment with the title of the goods remaining in the manufacturer unless and until the goods were sold to consumers by the retailer.
>
> The agent owes strict duties of loyalty, good faith, obedience, honesty, and care, to the principal as to how he (the agent) carries out the agency. The principal (the manufacturer) owes certain duties in connection with reasonable expenditures the agency may have to make. The principal must indemnify the agent for liabilities that the agent incurs in carrying out the principal's business (Hewitt, 1956, p. 7).
>
> The franchisee, rather than the agent, has the trappings

of an independent businessman. The agent is viewed as an extension of the principal (supplier). In North America, franchising is becoming a dominant form of retailing. It is also strong in services and is starting to make an impact in manufacturing. In 1980, there were 488,000 franchises in the U.S. with sales revenues estimated at $338 billion[1] ("Franchising...", 1980, p. 54).

There are a myriad of possible franchise arrangements: between manufacturers, manufacturer and wholesaler, and manufacturer and retailer; between wholesalers and between wholesaler and retailer; and between retailers. Arrangements between manufacturers are in essence licensing agreements, with the licensor functioning as the franchisor, and the licensee as the franchisee. Automobile and truck dealerships and service stations are examples of franchise systems involving manufacturers and retailers, and soft drink manufacturers employ franchise agreements with wholesalers, namely the bottlers.

Retail and service franchise systems such as McDonald's or Holiday Inn differ from the manufacturer or wholesaler systems. In the case of the former, the need to replicate a particular model of operation from start to finish necessitates a high degree of uniformity and conformity. It appears that the greater the distance from the manufacturer to manufacturer franchising system, the less autonomy will the franchisee have to manage his operations, even though he may have invested his

[1] For an overview of franchising in Canada, see "Franchising...the '80s", The Financial Post, Special Supplement, October 17, 1981, pp. F1-F24.

own capital, e.g. McDonald's. In short, he is not really an "independent businessman".

In the U.S., antitrust problems have resulted from the ways in which franchise agreements have been executed and administered. Abuses of the rights of franchisees and potential franchisees have been documented (Scherer, 1980, pp. 586-590).

By establishing rules and regulations for the franchisee, the franchisor is limiting the franchisee's scope for action. This situation is implicit in the franchise agreement and takes effect once the franchisee signs it; i.e., he becomes a quasi-independent businessman, because he gives up some of his commercial freedom of action when he signs the contract. The loss of independence of action may bring the franchise agreement within the scope of antitrust laws, because in all likelihood, it will include exclusivity, territorial and pricing provisions (Dixon and Wagner, 1973).

The Canadian federal government, in conjunction with many provincial governments, has been making a concerted effort to show small business the potential for doing sub-contract business, particularly from prime contractors to government (Industry, Trade and Commerce, 1981). Such programs are consistent with the policy initiative taken by the Canadian government in 1977 when it declared that:

> The federal government will study the feasibility of encouraging closer and mutually beneficial relationships between smaller and larger firms (Government of Canada, 1977, p. 31).

Many small Canadian businesses are now linked in a variety of sub-contractual arrangements with larger enterprises supplying them with parts, components or services. For the smaller manufacturer these sub-contracting relationships may solve marketing problems, and can be the source of a steady stream of orders together with technical support, and in some cases financial help.

As for the future, there is a discernible trend that suggests much greater sub-contracting on the part of large firms, particularly those that are foreign controlled. In response to federal and provincial government exhortations and incentives, an increasing number of large firms such as IBM, Xerox, Ford, General Motors and others have established and pursue programs designed to favour local sourcing, with special consideration given to small and medium sized Canadian firms.

In Japan,

> Small and medium subcontracting enterprises account for approximately 60 percent of the total number of small and medium enterprises...Such enterprises exist in a large number of industries. The percentage of small and medium subcontracting enterprises is especially high in the machine manufacturing and the fiber industries (The Japan Institute, 1980, p. 128).

The collective efforts by government and big business to foster subcontractual type arrangements with small firms is not without potentially serious consequences. There is the question of dependency of small business on big business. This type of public policy could have the effect of assigning a "satellite" service role to small firms, at a time when they

should pursue aggressively a wide range of market opportunities.

"Guaranteed" sales to big business are seldom cost free in terms of the commercial flexibility enjoyed by the small firm, particularly in the area of marketing. Furthermore, arrangements between big and small firms could limit the existing and future scope for competition in the marketplace; for example, between the potentially more innovative and aggressive small firms and big business. This is an area of research that has received little attention to date, and deserves careful study.[1]

SUMMARY OBSERVATION

Small firms are typically undercapitalized, understaffed and ill-prepared to deal with dynamic changes in the market place. Thus, they are more vulnerable than large firms, and less able to deal with rapidly changing technological, economic and political developments. The information drawn from the CFIB and NFIB annual surveys indicates that the perception and ranking of the problems strongly reflect the state of the economy; e.g., inflation and high interest rates.

Most of the problems facing small business can be attributed to lack of management competence. This observation is common to the findings of many of the studies surveyed in this chapter.

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[1] A preliminary study by Rein Peterson entitled, Small and Large Firms Together (Phases I and II describes "some of the natural relationships that exist between small and larger firms, trade associations, and industry institutes". This "exploratory narrative" was prepared for the Small Business Secretariat, Government of Canada, Ottawa, March 1978.

However, it is a finding which is coming under increasing attack by members of the small business community and some scholars. The methodology employed in some of the surveys and studies has been questioned, and the lack of recognition given to the impact of external forces on the operations of small firms has been criticised. There is need for further in-depth research on this subject area. The implications of the survey of the small business management literature for competition policy is dealt with in Chapter 6.

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CHAPTER 5

DEVELOPMENT OF COMPETITION POLICY AND SMALL FIRMS

Efficiency considerations provide an economic rationale for firms of different sizes, but without the development of the corporate form of organization, it would have been difficult to provide the institutional framework which would allow the economic rationale to be realized.[1] Once the corporation became widely used, entrepreneurs were able to assemble large amounts of financial capital and have an improved method for sharing risks. While problems of restraint of trade existed prior to the existence of corporations, this institution permitted restraint of trade to be exercised on a larger scale than had previously existed. The development of competition or antitrust policy in North America is associated with the increasing use made of the corporate form of organization, and in this context small firms play a definite role.

5.1 THE UNITED STATES

In North America, the impact of the operations of large firms on small firms led the latter to bring to bear political pressure to enact new or additional antitrust legislation. In the U.S., a wave of mergers from 1896-1903 resulted in increased concentration in a number of industries.

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[1] "(t)his change (incorporation) by itself, contributed more to the development of industrial society than most technological innovations that one could name", in "Basic Economic and Policy Considerations", (Skeoch, 1972, p. 8).

> In the steel, tobacco products, petroleum refining, sugar refining, non-ferrous metal smelting, shoe machinery, typewriter and other industries, it is quite clear that mergers transformed oligopolistic or competitive markets into markets dominated by partial monopolists (Markham, 1955, pp. 155, 158).

The small business lobby which reacted to these developments consisted mainly of farmers, who had considerable political influence. In fact, even prior to this merger wave, farmers had complained to legislators about the terms on which they dealt with large firms as suppliers of transportation services, especially the railroads, as suppliers of farm equipment, and about the large food handling and processing firms as buyers of farm products.

> The early state antitrust laws, the Sherman Act, and the Interstate Commerce Act can be seen as the politicians' response to agrarian discontent (Rosenbluth, 1959, p. 200).

John D. Rockefeller I is a prime example of how corporations were used to enhance market power, initially through the collection, refining and distribution of oil, to the disadvantage of the large number of small independent crude oil producers in the U.S. (Sampson, 1975, pp. 18-42). Standard Oil's monopsonistic behaviour towards these small producers was a major reason for the passage of the Sherman Act in 1890, although it was to be 21 years before the Standard Oil Trust was dissolved, and even then not very effectively.

There is a Rockefeller connection to Canadian competition policy through Mackenzie King, who as Minister of Labour was responsible for the passage of the Combines Investigation Act of 1910.

Mackenzie King in 1913 was employed by the Rockefeller Foundation as an industrial relations consultant in an attempt to improve Rockefeller's image with labour. King was familiar with the antitrust developments taking place in the U.S., and this experience may have been responsible for his emphasis on publicity as a way of preventing and correcting abuses of market power. On his return to office, King introduced the Combines Investigation Act of 1923 (Dawson, 1958).

Small firms again found a sympathetic audience in the U.S. Congress in 1913, when the Clayton Act was passed dealing with price discrimination (section 2), and tying contracts, requirements contracts, and exclusive dealing arrangements (section 3). In addition, the 'Fair Trade Movement' which promoted resale price maintenance was initiated by the small business lobby. This lobby received the backing of Supreme Court Justice Louis Brandeis, who was a strong critic of big business prior to and during his appointment to the Supreme Court (Scherer, 1970, p. 513).

Small business concern with distribution arrangements in North America emerged as changes took place in retailing. Chain grocery stores began to evolve in the 1920's and provided strong competition to small independent retail stores. In particular, the chain stores pressured suppliers to give them more favourable terms than those received by smaller competing stores. The Federal Trade Commission, in a 1934 report, documented these activities, and the report led in 1936 to the

Robinson-Patman Act which amended the price discrimination section, of the Clayton Act (Federal Trade Commission, 1934). Representative Patman, the bill's co-sponsor, noted that the act was designed "to give the little business fellows a square deal". Scherer, in reviewing the passage and later implementation of the Robinson-Patman Act, stated that

> There is virtual unanimity among students of the Act that, in sharp contrast to the other anti-trust laws, its motivation was a desire to limit competition, not to enhance it (Scherer, 1970, p. 496).

One consequence of the Robinson-Patman Act was to prevent the reorganization of the brokerage function. Prior to the rise of chain stores, small manufacturers and processors sold their output to independent sales brokers, which acted as intermediaries for many of the small retail outlets. The chain stores were structured so as to internalise the brokerage activity and perform it themselves, and as a result they asked suppliers for the price charged to brokers rather than the price charged by brokers. Subsequent Robinson-Patman Act decisions thwarted this reorganization of market transactions, serving to protect both the brokers and the small producers from pressure brought to bear on them by large buyers (Baum, 1964, p. xiv).

One purpose of legislation dealing with price discrimination is to prevent predatory pricing. However, pricing that may appear discriminatory, can actually reflect socially desirable price competition although it may be viewed differently by those firms which are adversely affected by the competition.

The challenge for public policy has been to develop criteria which will permit a distinction to be made between pricing which is predatory, and that which is normal and desirable from the viewpoint of competition. A failure to make this distinction may result in too many restrictions being placed on pricing, such that efficiency creating reorganizations, which replace market transactions with internalization of activities, will be discouraged.

The movement supporting resale price maintenance (fair trade) in the U.S. was led by small business interests, especially the druggists. In 1931, the State of California passed a law making resale price maintenance (RPM) legal. Nine other states passed similar laws by 1935, and the Supreme Court upheld the states' position in 1936. The laws applied to intra-state trading only, and in 1937 the retail merchants' lobby, consisting mainly of small firms, managed to get Congress to pass the Miller-Tydings Act, which exempted resale price maintenance agreements from the provisions of Section 1 of the Sherman Act, where these agreements are authorized under state laws. It thus became possible to practise RPM in both intra-state and inter-state trading.

The fair trade legislation in a number of states had later to be amended to include 'non-signer' clauses, so that a retailer who did not want to sign an RPM agreement with a manufacturer was forced to, if there was at least one retailer who had such an agreement.

In 1951, the U.S. Supreme Court ruled against the legality

of 'non-signer' clauses. The retail merchants lobby again went into action and, along with other interests, persuaded Congress to pass the McGuire Act in 1952, which amended Section 5 of the Federal Trade Commission Act, and reinstituted the 'non-signer' clause. An appeal on the constitutionality of the McGuire Act was rejected. The history of fair trade legislation in the U.S. is one in which small business has played a leading role in supporting legislation which permitted conduct that Canada decided was anti-competitive and banned in 1952.

The interests of small business received further explicit recognition when the Small Business Act created the Small Business Administration in 1953. This Federal agency was charged with responsibility to advance and protect the interests of small business. U.S. Congressional committees have consistently held hearings on small business and at the beginning of the 95th Congress six subcommittees were established, one of which, The Subcommittee on Antitrust, Consumers and Employment (of the Committee on Small Business, House of Representatives) was charged with examining antitrust policy and small firms. This Subcommittee reported on November 9th, 1978, subsequent to hearings which were the combined product of small business, academics and the Congressional Research Communities.

This report is not an in-depth study of the small business sector in the U.S. (as is the Bolton Report for the U.K.), but the conclusions are of interests. First, the role and importance of small business in the economy is described as being "the

cutting edge of competition", "the vanguard of innovation and invention", "the nation's job creator", "a source of leadership", and as "the entrepreneurial outlet". In arriving at these conclusions, the subcommittee noted a "glaring absence of (a) comprehensive data base dealing with the future of small business" (p. 4), but expressed the view, based on available data, that the share of small business was declining in the manufacturing and service sectors, although the number of small firms had increased.

On antitrust policy, the subcommittee concluded that

> ...the Federal Trade Commission and the Antitrust Division of the Department of Justice are not adequately enforcing the antitrust laws and are, thereby, severely limiting the ability of small business to compete effectively in the marketplace. Specifically noted was the failure of the Federal Trade Commission to adequately enforce the Robinson-Patman Act, a statute which these leaders believe was particularly designed to protect the small business community (pp. 26-7).

Besides price discrimination, the other major antitrust concern of the subcommittee was the extent to which mergers were accounting for the disappearance of small firms and increased concentration in industries. Consequently, the subcommittee made the following recommendations:

> The Federal Trade Commission and the U.S. Department of Justice should:
>
> (a) Develop for submission to Congress affirmative legislative proposals in the area of the antitrust laws designed specifically to stop and to reverse the trend of the continuing decline of small business;
>
> (b) Vigorously enforce the existing antitrust laws in a manner designed to maximize efforts to forestall the

decline of small business with particular emphasis on the enforcement of penal provisions against so-called "white collar" antitrust violations;

(c) Develop for submission to Congress proposals to reverse the trend toward increasing aggregate concentration through mergers and acquisitions;

(d) Focus enforcement efforts on predatory marketing and advertising practices which place small business at a serious competitive disadvantage;

(e) Continue and expand the practice of intervention in Federal agency proceedings in order to insure maximum freedom of entry by small business into monopolistic, oligopolistic and regulated industries; and

(f) Continue to work with State attorneys general and district attorneys in order to insure a coordinated and comprehensive enforcement of the antitrust laws at local, State, and Federal levels.

The U.S. Department of the Treasury in Cooperation with the Federal Trade Commission, the U.S. Department of Justice and the Small Business Administration should develop legislative proposals to amend existing tax laws which encourage and facilitate the increasing trend toward mergers and acquisitions (pp. 39-40).

5.1.1 Political Power

There is another strand in the history of U.S. antitrust policy which concerns small business. In his comprehensive review of the U.S. antitrust laws, Neale draws attention to social theory which recognises a distrust for any centres of power, political or economic, and which is reflected in the U.S. political system as well as in the administration of antitrust laws. Politically, the U.S. constitution contains checks and balances between the executive, legislative and judicial arms of government. One expression of the same view in the economic arena is contained in Judge Hand's dictum in the Aloca case:

> It is possible, because of its indirect social and moral effect, to prefer a system of small producers, each depending for his success on his own skill and character, to one in which the great mass of those engaged must accept the direction of the few (Neale, 1960, p. 420).

In order to examine these essentially non-economic benefits of small business, questions have to be examined about the extent to which the diffusion of power in small business protects against the concentration of political power; about the effect that the exercise of reliance in small firms contributes to desirable character formation; and about whether decentralised ownership of property rights via small business promotes political and social stability (Rosenbluth, 1959, p. 207). These are questions which are not easily evaluated, but they are ones which underly the view that small firms are good for society, other than in economic terms.

Similar distrust of centres of power does not appear to prevail in Canada, at least not in terms of the passage of strong antitrust laws and not based on the existing jurisprudence. However, this may not be a fair test. The concern over large corporate size has been reflected in the establishment of Royal Commissions and inquiries on topics such as corporate concentration, newspapers, petroleum, telecommunications, steel, and banks. The existing weakness of the Combines Investigation Act has meant that special inquiries have had to be set up. The concern over corporate power does exist in Canada to some extent, but the administration of the Act has not permitted the concern to be expressed.

5.2 CANADA

During the 1920's and 1930's, similar changes were taking place in the organizational structure of firms and industries in Canada. The same type of economic forces promoting plant and firm scale economies were at work, and a number of the firms were wholly or partly-owned subsidiaries of U.S. firms. Thus, the U.S. industrial structure reached into Canada, e.g., Alcoa and Alcan, Western Electric and Northern Electric (now Northern Telecom Ltd.), and certain of the grocery chains are examples of the cross-border corporate reach. It is not surprising therefore to find action taking place with respect to price discrimination, resale price maintenance and other distributive arrangements affecting the interests of small firms.

5.2.1 Price Discrimination

In 1935, the Canadian government legislated a new provision in the Criminal Code (section 498A) dealing with price discrimination and predatory pricing. This is the origin of the present Section 34(a) of the Combines Investigation Act. Section 498A was depression born and was related to the Report of the April 1935 Royal Commission on Price Spreads, which recommended that the federal government establish a trade and industry commission to regulate commerce and industry, in the light of the ruinous competition being experienced by both large and small business. The Report also recommended legislation to prevent unfair price discrimination and predatory pricing.

The first recommendation led to the passage of the Dominion Trade and Industry Commission Act.

> Under the...legislation, a form of industry self regulation was to be allowed. In other words, instead of reinforcing competitive forces, one provision of the competition policy legislation was designed to prevent the ruin of competitors, particularly small business (Gorecki and Stanbury, 1981).

One argument for the Commission was the need to protect small business, which would be reluctant to bring forward cases if they had to be identified with a complaint. This argument continues to explain to-day why small firms, in whose interests the Combines Act often works, tend to be lukewarm in their support for amendments to strengthen the Act.

The constitutionality of both the Act and Section 498A was challenged. Part of the Act was held to be ultra vires of the Federal government, but the constitutionality of Section 498A was upheld. The debate on Section 498A noted that the Report had stressed the high level of concentration in many

manufacturing industries, and the competitive situation faced by smaller firms.

> ...we have 700,000 farmers who must do business under the shadow of that control (by the meat packers).
>
> .What happens to the individual, to the small merchant with limited resources, who goes up against an institution with forty million dollars behind it? What earthly chance has he in the courts against a big institution like that?
>
> What about the flour milling companies, which control sixty-three per cent of the capacity of this country, and what about their relations with the 350 cdd small competitors?...it is the ruthless power of huge capital concentration against individual operations.
>
> I say...that this country is waiting for the House of Commons to lay down rules which will relieve countless thousands of our citizens from the unfair and predatory practices to which they have been subjected in the past (Hansard, June 11, 1935, pp. 3515, 3517, 3518, 3519).

The debate highlighted the confusion as to whether the price discrimination provisions would protect competition or competitors. In the minds of many participants the protection of competitors was equated with the protection of competition. The debate drew attention to a second distinction, that involving 'fair' and 'unfair' competition, which has plagued this type of legislation. While it is argued that pricing with predatory intent should be banned, the identification of such intent is often difficult to make, and desirable competitive pricing practices tend to get labelled predatory. What is 'fair' and 'unfair' often depends on the position of the firm arguing the point. However, unlike the U.S., there has been very little judicial activity in Canada, and one observer's

view is that

> Those who are familiar with the U.S. price discrimination law, the Robinson-Patman Act, and the literally thousands of investigations and cases which have arisen under it, will appreciate why it is perhaps desirable that Section 34(a) of our Combines Investigation Act is inoperative (Green, 1980, p. 181).

The Skeoch-Macdonald report, Dynamic Change and Accountability in a Canadian Market Economy (Ottawa, 1976) proposed that the criminal sanction against price discrimination be replaced by a civil sanction because of the difficulty of interpreting the effects of alleged discriminatory behaviour. One dissent from this recommendation suggested that there should be both a civil and a criminal sanction. It is our view that only a civil sanction should be used, but that it should be contained in a section dealing with discriminatory behaviour which would be broader than just price discrimination.

5.2.2 Resale Price Maintenance

The Canadian government legislated a ban on resale price maintenance and refusal to deal in December 1951, now Section 38 of the Combines Investigation Act, despite opposition from the retail lobby. This move followed the publication of the MacQuarrie Committee's Interim Report on Resale Price Maintenance. The origin of the MacQuarrie Committee is itself of interest. In 1947, the Director, Mr. F.A. McGregor, initiated an investigation of the Flour Milling Industry which led to the preparation of a report alleging price fixing in the industry. The government refused, contrary to the law, to

publish the report, and this led to the Director's resignation in October 1949. Subsequently, the MacQuarrie Committee was established by the government to consider changes to the Combines Investigation Act (Rosenbluth, 1963, pp. 10-16).

Certain ministers in the government opposed the publication of the report, which alleged criminal activity on the part of business executives. These same executives had been part of the wartime scheme of government sponsored pricing and production controls, the Wartime Prices and Trade Board which had been sanctioned by legislation. The wartime practices had spilled over into the postwar period and some ministers and corporate executives felt that this type of conduct still had government support. The Director, Mr. McCregor, disagreed. In the course of the debate surrounding the Director's resignation, certain members of the government made it clear that from a planning point of view they preferred to deal with a few firms and a concentrated industry, because there were fewer executives making the key decisions for the industry (Rosenbluth, 1963, pp. 14-15). Thus, some government policy makers were shown to favour large versus small firms on the grounds of the efficiency with which policies could be communicated to and implemented by business. To this day, there are conflicting views on the role of competition policy within the Federal government.

The preceding is a digression from the discussion of resale price maintenance, but the origin of the 1951 legislation throws important light on the diversity of the government's attitude towards small business. There was an active small business lobby against the abolition of resale price maintenance in representations to the MacQuarrie Committee:

> Retailers' associations argue that RPM helps to keep the small independent retailer in business.
>
> In the absence of RPM....they (large department stores) are in a particularly advantageous position to use the 'loss-leader' device in order to attract more business and gradually eliminate their smaller rivals (MacQuarrie Committee, 1952, pp. 59-60).

In a parliamentary debate, subsequent to the introduction of Section 34, which became effective on December 29, 1951, it was noted:

> I well remember that in the committee suggestions were made that the small businessman would be completely put out of business when this legislation went into effect. Well, we have had a few months to view the situation. I find that the same small businessman who was in business last December is carrying on today (Hansard, June 2, 1952, p. 2825).

The 1951 ban on resale price maintenance was weakened somewhat in 1960, when an amendment permitted an exemption where it can be shown that loss leader selling or other abuses have taken place.

Two cases have tested the loss leader amendment. In one case, a supplier established effective resale price maintenance by arguing that in its absence loss-leadering would occur, while in another a manufacturer refused to supply a firm because it had engaged in loss leader selling. Only in the latter case

did the court uphold the actions of the firm (Green, 1980, pp. 192-4). More recently, in the Stage 1 amendments to the act, provisions have been added as 'reviewable trade practices' dealing with refusal to supply and consignment selling, both of which can relate to resale price maintenance.

5.2.3 Other Trade Practices

Exclusive dealing, tied sales, requirements contracts and full-line forcing are all aspects of market conduct

involving vertical relationships in distribution between buyers and sellers. Small business has had a keen interest in these provisions both in the U.S., and in Canada where they became explicitly part of the Combines Investigation Act with the passage of the Stage 1 amendments in 1976, and are evaluated under the provisions related to 'reviewable trade practices'. Separation of this conduct from the criminal law provisions of the act is recognition that there are no hard and fast criteria which can be established to determine the effect of these practices, many of which involve small firms.

To-date there has been only one ruling by the Restrictive Trade Practices Commission (RTPC) concerning exclusive dealing, the Bombardier case, which involved a small distributor of Bombardier's snowmobiles. There was also one case of refusal to supply gasoline to a chain of stores, Perrette Dairy Ltd., which was combining the sale of groceries with the sale of gas (Rosenbluth, 1981). However, Perrette managed to obtain supplies of gas before the case was heard by the RTPC. This outcome is indicative of the possible preventative nature of the 'reviewable trade practices' section of the Canadian legislation. Whereas there have been few cases under the section, the existence of the provisions may deter the practices from occurring, or cause a change in conduct once proceedings are begun. To be effective small firms have to understand the nature of the section, and the RTPC has to consider how it can be made effective through the exercise of publicity.

Summary Observation

These examples of the role of small business in the development and administration of antitrust policy in North America, suggest that the policy has not only recognised the interests of small business, but at times the recognition has led to anti-competitive consequences. The review also implies that small business has often been pitted against big business in its search for legislative protection. However, at other times, small business has interests which places it in the same camp as big business, and the idea that big and small firms are in opposing camps has to be understood in this light. For example, small and large firms may have similar interests in the case of taxation and subsidy programs. This duality of

interest helps to explain the sometimes lukewarm nature of support given by small business to amendments to the Combines Investigation Act.

5.3 CURRENT ADMINISTRATION IN CANADA

The administration of competition policy reveals some of the problems faced by small firms. This section of the survey is based on records of the Bureau of Competition Policy and the Foreign Investment Review Agency (FIRA), previous studies of competition policy, reports by the Restrictive Trade Practices Commission, and interviews with selected individuals concerned with the administration of competition policy.

5.3.1 Daily Register

The Bureau of Competition Policy records inquiries on a daily basis concerning the administration of Competition Policy and related matters. From this record it is possible to show the concerns of small business, although the type of inquiries registered may be biased in a number of ways. Firms will contact the Bureau when they feel they have a problem; only those firms that know about the Bureau will make contact; the inquiries may relate to matters other than those concerned with competition policy, and the problems may merely reflect management inadequacies on the part of the firms. In addition, not all inquiries may be recorded in the daily register. However, despite these biases, the record of inquiries does document

many of the firms, which have taken the trouble to contact the Bureau, usually with a problem. Each contact also provides the Bureau with an opportunity to educate firms about the nature and scope of competition policy.

The incoming inquiries are classified into three categories, 'Complaints', 'Compliance' and 'Other'. The record for any particular month shows those files which are completed and those which are incomplete. For 1980, the data by month are shown in Table 5-1 Each inquiry is dealt with in writing or by telephone by an officer of the Bureau.

A closer examination of a recent month provides some illustrations (albeit not necessarily typical) of the concerns of small business. During the month of June 1981, there was the following record of activity.

	Completed	Incomplete	Total
Complaints	24	10	34
Compliances	7	1	8
Others	15	2	17
	46	13	59

The time spent on each complaint might range from half-an-hour to several days.[1]

The information recorded in the initial complaint file does not record the size of the firm, but from the description

[1] If a complaint is not dealt with quickly and more time is spent on it (more than 2 days), it becomes a preliminary enquiry, and if further time is needed it becomes a formal enquiry. The number of formal inquiries in progress at the end of the year are recorded in the Director's Annual Report, e.g., 78 in 1979-80. A formal inquiry implies that the Director's search powers have been used.

TABLE 5-1

PRELIMINARY INQUIRIES RE COMPETITION POLICY, 1980[a]

	Total	Complaints		Compliance		Other	
		Completed	Incomplete	Completed	Incomplete	Completed	Incomplete
Jan.	60	------31-------		------12-------		------17-------	
Feb.	62	------32-------		------ 9-------		------21-------	
Mar.	60	------32-------		------ 6-------		------22-------	
Apr.	69	25	18	5	8	13	-
May	50	17	13	11	3	6	-
June	48	15	19	3	1	8	2
July	90	44	17	10	-	17	2
Aug.	57	21	21	9	-	6	-
Sept.	64	32	18	9	-	3	2
Oct.	90	19	23	22	2	18	6
Nov.	104	32	25	16	3	23	5
Dec.	86	28	22	19	1	14	2
Total	840	504		149		187	

Note: a. The figures relate to the activity undertaken during a month. For example in April 1980, 43 complaint files were opened of which 25 were completed and 18 were incomplete: the 18 incomplete do not appear in the subtotals for subsequent months as completed or incomplete complaints.

SOURCE: Bureau of Competition Policy, Department of Consumer and Corporate Affairs.

of the issue and the industry concerned it is possible to infer the type of business involved. For the 34 completed and incomplete 'complaint' files, individuals and small firms are well represented. The complaints of small firms tended to focus on the pricing and supply practices of other small firms, as well as about medium-size and large firms. Refusal to supply small firms accounted for 15 of the 34 cases, tied selling - 2, resale price maintenance - 2, price discrimination and loss-leader selling - 3, and other - 12. The 'other' category included complaints about price fixing and mergers.

Large and medium-size firms were potential suppliers in about half the 15 refusal to supply cases involving small firms. A number of complaints came from franchise holders or from firms with exclusive dealerships. The four 'compliance' cases involved both large and small firms regarding the administration of the act and the meaning of particular sections. The incomplete compliance case involved a case of attempted bid-rigging.

The seventeen 'other' inquiries were made by large and small firms and by Members of Parliament on behalf of constituents, who were usually individuals and small firms. Many of the 'other' enquiries concerned the proposed amendments to the act, or questions related to the petroleum inquiry before the RTPC.

The record kept by the Bureau of Competition Policy provides a starting point for identifying concerns raised by business involving the operation of the market place. The information provided in the files is not detailed or complete, but it suggests the type of problems which firms, including small firms, are experiencing. Some of the concerns are not competition policy related, but arise because of self-inflicted problems due to poor management, while others are complaints about matters not dealt with under the Combines Investigation Act.

The files, therefore, provide raw data, which, when refined, could be used to evaluate aspects of competition policy including the concerns of small business. A preliminary evaluation of the data reveals that problems of distribution, especially refusal to supply are of prime concern to small business. The research value of the files would be increased if further details of the preliminary inquiries were included by the recording officer.

The process which is used to administer these files reveals a part of the process of administering competition policy. The response to inquiries made by officers of the Bureau is part of this process. The approach to the complaint procedure by large and small firms tend to be different. Large firms tend to deal directly with the Director either on their own or through their lawyers. Smaller firms are dealt with by the Director's officers, and by the Director where the facts raise major substantive issues.

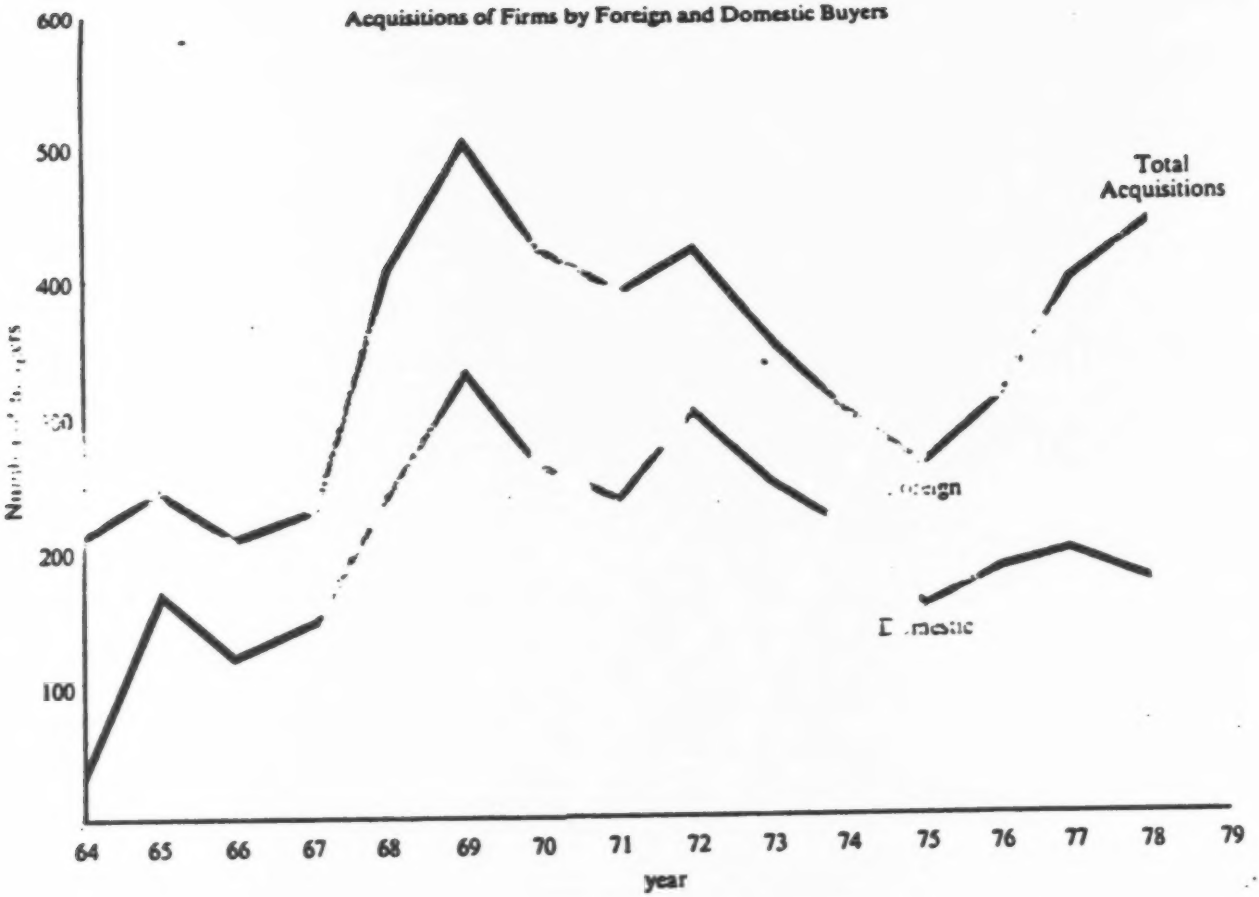
5.2.2 Merger Record

The Director's annual reports have recorded the merger activity in Canada in recent years. The average number of mergers per year has been increasing from around 200 in 1960-1964, 300 in 1965-1969, 375 in 1970-1974 and almost 400 in 1975-1980. Over the past three years, 1978 to 1980, the average was 458 mergers per year - Exhibit 5-1. The distribution of mergers by type, weighted by value of shipments, has altered from 45% horizontal[1] and 55% vertical and conglomerate, to 21% and 79% respectively over the period 1973 to 1978 (Stanbury, 1981, p. 12). The average sales size of the acquired firms was $2.39 million in 1970 and $3.04 million in 1971 (Royal Commission, 1978, p. 149).

Public attention has been given primarily to those mergers involving large firms. However, the implications for small firms arise both in the case of large firm mergers, as well as where small firms are directly involved. Stanbury states that horizontal mergers have greatly increased concentration in Canada in nineteen industries - Exhibit 5-2. In a number of these industries

[1] Horizontal includes geographic market and product market extension mergers. The increased relative share of vertical and conglomerate mergers is similar to U.S. experience. In the U.S. successful prosecution of horizontal mergers was a major reason for the change, a situation which was far from the Canadian experience.

EXHIBIT 5-1



Source: Merger Register maintained by the Director of Investigation and Research (see Chapter V for details). The use of FIRA records since 1974 and the inclusion of the services sector since 1976 have likely increased the number of mergers recorded by the Bureau.

NOTE: Data before and after 1974 are not strictly comparable because coverage of foreign takeovers improved after the establishment of FIRA.

EXHIBIT 5-2

Canadian Industries In which Mergers Are Alleged to Have Increased Concentration

- Cement - in a number of regional markets
- Concrete/ready mix - in a number of local markets
- Department stores (e.g., takeovers by The Bay)
- Newspapers (e.g., Thomson's Takeovers of F.P. Publications)
- Brewing (e.g., the takeovers by Canadian Breweries
- Sugar (e.g., B.C. Sugar's takeovers of Manitoba Sugar)
- Yeast (see the RTPC Report)
- Cast Iron Soil Pipe (see the RTPC Report)
- Propane distribution (see the RTPC Report)
- Major Appliances (i.e., the creation of CAMCO)
- Newsprint/Pulp (e.g., Abitibi-Price merger)
- Milk processing (dairy products including cheese)
- Fuel oil distribution
- Meat packing/poultry processing
- Grocery wholesaling (e.g. merger of Provigo and M. Loeb
- Forest Products
- Fish processing (both Atlantic & Pacific) (e.g., Nickerson and National Sea Products merger)
- Grain elevators
- Accounting firms (a series of mergers in 1979-1981)

Source: Stanbury, 1981, p. 6.

large firms either produce alongside small firms, or there are a significant number of small firms, e.g., newspapers, accounting and fuel oil distribution. Often it has been the small firms that have been acquired in the mergers. In other industries small firms are affected because of their relationship as suppliers to large firms, e.g., department stores, pulp, milk processing, grain elevators, or as buyers from large firms, e.g., grocery wholesaling.

Sixteen mergers, drawn from the Director's files, have been listed as examples of mergers which should have been screened and which were not because of the existing state of jurisprudence regarding mergers. No firm names are given. What is notable about these examples, for present purposes is the extent to which the industries concerned are generally populated by small firms,[1] e.g., city waste disposal, film processing, commercial laundries, linen supply, propane distribution, heating oil distribution, and automobile trim. A number of these are service industries where small firms operate. In order to determine whether competition would be likely to be lessened, it would be important to know about the condition of entry into the market. For many retailing firms entry is not difficult, and the existence of potential if not actual competition would be a disciplining factor on the relevant market, which might be highly concentrated in terms of existing firms.

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[1] The argument that these cases should have been scrutinized was based on the fact that although the firms involved might have been small, they were large relative to the market in which they operated (Stanbury, 1981, p. 14). It has been the policy of the Bureau to investigate mergers based on market share considerations.

There is a substantial literature which deals with the factors affecting the disappearance (failure) of small firms in general (see Chapter 4) and through mergers. One earlier study examined the impact of taxation on the disappearance through acquisition of small firms (Butters, 1951). The relative rates of income tax, corporate and personal, and capital gains tax, as well as estate taxes and sales taxes were found to be important factors affecting the owner's decision to sell a small firm. Particular incentives to sell arose when problems of management succession, retirement or death occurred. Similar tax factors need to be examined in the Canadian environment, with recognition given to the changes in taxation which have occurred in recent years, and which have been proposed from time to time. Some mergers may be a response to potential as opposed to actual changes.

The impact of mergers on small firms cannot ignore the role of the Foreign Investment Review Agency (FIRA) in its evaluation of foreign takeovers in Canada. There is a cut-off point whereby acquisitions of small firms either do not have to be reported to FIRA, or require an abbreviated form of notice. For example the abbreviated form is required for the acquisition of a business with gross assets of less than $2 million and fewer than 100 employees.[1] Also, the Act does not apply to "the acquisition of control of a Canadian business whose gross assets do not exceed $250,000, and whose gross revenues do not exceed $3,000,000 by a person who is already carrying on in Canada a business related to the

[1]These levels have been changed by the Federal Budget of June 1982.

one being acquired" (FIRA, 1977). These cut-off points were established some years ago, and due to inflation, more smaller firms are now having their activities reviewed by FIRA than in previous years.

The criteria used to evaluate foreign takeovers are much wider than is typically the concern of competition policy. FIRA considers issues such as employment, research and development, local sourcing and regional effects. FIRA criteria embrace these general industrial policy effects as well as the impact on competition in Canada. Although FIRA has been criticised for not providing detailed explanations for its decisions, and although very small firms are excluded from the review process, the type of information collected and evaluated by FIRA would be useful for further research into mergers involving small firms in Canada. In particular, the information would assist in understanding that section of the small business population which is foreign-owned.

A number of firms which are part of the small business community in Canada, are at the same time subsidiaries of much larger foreign companies. The administration of competition policy has to decide whether it will take the 'separate entity' or the 'unitary' legal approach to foreign-owned firms. The 'separate entity' approach, dealing only with the subsidiary, may involve a small firm; the 'unitary' approach, dealing with the Canadian subsidiary as part of the foreign parent company, will usually be dealing with a much larger firm. The 'unitary'

approach will give rise to issues of extraterritoriality, which are familiar to Canadian administrators of competition policy. However, the legal questions raised by the two approaches and the conflicting treatment accorded these questions in different national jurisdictions are worthy of further research (Griffen, 1974).

This proposal may seem a long way from the topic of small firms and merger policy in Canada, but one of the fairly unique aspects of the Canadian corporate landscape is the extent of foreign ownership. Some foreign subsidiaries are also small, and this grouping of small firms may give rise to some special considerations. At the same time, because of the existence of FIRA, there may be some information which would lend itself to further research.

5.3.3 Marketing Practices Branch

A further source of information on small business conduct can be gained from the Marketing Practices Branch of the Bureau of Competition Policy. This Branch deals with violations of the misleading advertising and deceptive marketing provisions of the Act, sections 36 and 37. The number of complaints has risen from 7,850 in 1976-7 to 9,431 in 1979-80: the number of cases before the courts has risen from 4 to 83 over the same period, according to the Director's annual reports. In addition the Branch conducts a program of compliance (Annual Report, Director, 1980, p. 71).

The Branch publishes, on a quarterly basis, the Misleading Advertising Bulletin, which contains summaries of concluded prosecutions that resulted in convictions under sections 36 to 37.3 of the Act. It also contains statements of the Director's position in relation to various issues.

The Branch has undertaken internal studies which classify the data collected about complaints when they were stored on a computer. For example, in the fiscal year 1974/75, the details of 5,066 files are described in Exhibit 5-3.

Firms with the most frequent complaints about their market practices were the major department stores, food chain stores and other large retail chain outlets. In the fiscal year 1972/73, thirteen firms accounted for 19% of all complaints.

This classification of complaints does not imply that there was always substance to them. For example, in 1981 when the number of complaints were running at about 10,000 a year, about 2,000 were investigated of which about 750 led to information visits by officials of the Branch, and

EXHIBIT 5-3

SELECTED DETAILS OF COMPLAINTS MADE TO THE MARKETING PRACTICES BRANCH, 1974-75

Total Complaints (Nos.)	5,066
Section 36 %	92
Section 37 %	5
Other %	3

Origin of Complaints

	%		%
By Telephone	60	Consumers	87
In writing	35	Competing Firms	4
Other	5	Other Firms	2
		The Director	2
		Other	5

Type of Advertisement Identified in Complaint

	%
Print Media	60.5
Direct Mail	7.9
Labels and price stickers	6.9
Signs in stores	6.5
Broadcast Media	5.8
Catalogues	5.7
Outdoor signs	3.7
Other	3.0

Principal Product Groups Identified in Complaints

	%
Food	13.5
Motor vehicles and Accessories	11.5
Personal Services	10.3
Other (mainly services)	64.7

Exhibit 5-3cont'd.

Problem Area of Complaints

	%
Unavailability of advertised product	33.7
Non-disclosure of material information	11.2
Failure to disclose conditions	3.7
Claims of savings not fulfilled	9.9
Claims regarding some aspect of quality	7.0
Claims regarding some aspect of performance	5.8
15 other problem areas	28.7

SOURCE: Marketing Practices Branch, Consumer and Corporate Affairs, Ottawa.

N.B. The relevant sections of the Act were numbered differently prior to the 1976 amendments.

about 130 convictions were obtained. The balance of the complaints either dealt with issues not covered under the Act, were minor, resulted in the evidence disappearing, or could not be handled for lack of resources.

It is still the case that over half the complaints are against national companies (with operations in more than one province) of the type listed above, but only 25% to 30% of the convictions are against national companies, and the balance are against small and medium-size firms. Almost 90% of the complaints concern retail distribution, and of the eleven categories of marketing practices listed in the Act (Sections 36(1)a, 36(1)b, 36(1)c, 36(1)d, 36.1, 36.2, 36.3, 36.4, 37, 37.1 and 37.2), the overwhelming number of complaints relate to Sec. 36(1)a on misleading advertising.

The Branch possesses a considerable volume of data, which could be analysed to determine the extent to which complaints about marketing practices relate to actions undertaken by small firms. Some of this information could be collected from files and some from court cases. At present, it is possible to state that while over half the complaints are made about larger firms, over half the actual convictions relate to small and medium-size firms. There are a number of possible reasons. First, the larger firms tend to have more customers, many of whom may not

be adverse to complaining about a highly visible operation, such as a department store. Second, the large firm may be more careful about not breaking the law, and thus becoming involved in the adverse publicity of a court case. On the other hand, the smaller firms may take more risks and may not be as well advised about the limits of the law. Third, the larger firms may have better legal counsel once a case is taken to court.

The subject of marketing practices is closely connected with the service sector, especially retail trade, and with the function of distribution. Small firms are prominent both in services and in distribution, and the data on marketing practices would be useful for examining these areas.

5.3.4 Published Reports

In the pre-war period, 1923-1940, the Director prepared twenty-six reports on restrictive trade practices, of which fourteen were published. Five reports related to the distribution of fruits and vegetables, and nine to the distribution of coal, milk, drugs, films, gasoline and tobacco. Small firm interests were prominent in these reports. Two other reports deal with building contractors and ten with combines among manufacturers of bread, fruit baskets, radio tubes, rubber footwear, matches, flour milling, clay products, wood preservation and paperboard containers.[1] In all twenty-six reports, a small firm interest could be identified, and in some reports the focus was on small firms. Distributive arrangements affecting small firms was a key issue area.

[1] Details of published and unpublished reports can be found in Skeoch (1966), pp. 97-109.

In the immediate post-war period up to 1949, reports were published on international cartels and on combines in matches, glass, dental supplies, optical goods, bread and flour. The match case which followed from the Director's report, highlighted the numerous ways in which predatory practices could be engaged in by a large firm in order to drive out smaller firms, and to discourage potential competitors from entering the market (Eddy Match v. The Queen, 109 C.C.C. 1, 1954).

The Flour Milling Inquiry, which led to the Director's resignation in 1949, was initiated in 1947. As discussed above, the case involved the wartime support by the government for cartel arrangements, and the subsequent difficulty of certain parts of both the government and the industry to terminate these arrangements once the war ended.

One study argues that the fact that the twenty pre-war Director's reports dealt mainly with small business is consistent with the view that politicians do not rock the boat of their major financial contributors, the large firms. In 1949, when the Director did aim his sights on large firms, such as the flour millers, the government intervened to impede the inquiry. Subsequently the politicians were assisted by the courts which did not convict in two merger cases involving large firms in the beer and sugar industries (Rosenbluth, 1963).

This hypothesis could be used to explain why it has been such a long and tortuous process to obtain legislative passage of the Stage 1 and Stage 2 amendments to the Combines Investigation Act since the mid-1960's, while at the same time the Supreme Court has ruled in favour of large firms in the merger case involving K.C. Irving, and in the conspiracy case involving the major sugar companies (R. v. K.C. Irving, 32 C.C.C. (2d), 1977 and R. v. Atlantic Sugar, 54 C.C.C. (2d), 1980, p. 373).

An extension of the Rosenbluth-Thorburn study was made for the 1971-1975 period, when further amendments to anti-combines legislation were proposed (Stanbury, 1977). This study concluded that anti-combines policy receives almost no support among businessmen and that this contrasted with the situation in the U.S.

> American businessmen are prepared, in the final analysis, to live with anti-trust, in part because of their still strongly held private-enterprise ideology. The same is not true here...Many Canadian businessmen still appear to regard competition policy as not in any way supportive of markets and private enterprise. They speak of it largely as an intrusion on enterprise; they lump it with every other sort of unwanted government intervention in the market; and they do not accept that they ought - in their own, best longer-term interest - to live with anything more than the frailest, most deceptive shadow of a competition policy (McQueen, 1972, p. 55).

This portrayal of the situation needs to be modified. Big business is not supportive of anti-combines policy, or is only supportive of the legislation in its present weakened form. Small business, on the other hand, supports the policy in cases where its interests are threatened by big business,

although it may be fearful of expressing strong supportive views due to concern for retaliation from large firms. Many of the complaints to the Director originate with small business. At the same time, however, small business support is reduced due to a general dislike of any type of government interference in the market place.

The administration of the legislation has shown an increasing concern with the problems of small business as evidenced by the rising number of prosecutions regarding predatory pricing, price discrimination, refusal to supply and resale price maintenance. Prosecution in these areas rose from 2 in 1950-55, to 3 in 1955-60, to 11 in 1960-65 to 8 in 1965-70 to 16 in 1970-75 (and 9 in 1975-76). In relative terms, these cases accounted for the following percentage of total prosecutions in the five year periods: 22.2%, 15.8%, 61.1% 32.0%, 54.2% (and 69.2%) (Stanbury, 1977, p. 55).

A similar concern with distributive arrangements was reflected in the Stage 1 amendments, which eventually led to the inclusion of Part IV.1 of the Act dealing with reviewable trade practices - refusal to supply, consignment selling, exclusive dealing, market restriction and tied selling. Specific reference to these types of market conduct could be viewed as assisting small business in their dealings with big business. However, in the process of amending the legislation the wording of some of these provisions was altered in a way which appeared to weaken their effectiveness. For example, the wording of

Sec. 31.4(5)(C),

> ...prevents the application of orders by the RTPC in respect of exclusive dealing, market restrictions or tied selling to multiple product 'franchise' operations such as Canadian Tire, Shoppers Drug Mart, Becker Milk Stores, McDonald's, IGA grocery stores and others...The section does not, therefore, exempt the national oil companies operating through a large number of service station lessees (Stanbury, 1977, p. 182).

At one point, the Stage 1 amendments would have strengthened the ban on resale price maintenance. However, the final wording of the amended Section 38 permitted the practice of pre-ticketing goods without the requirement of noting that the pre-ticketed prices were suggested retail prices. The amendment as passed was favoured both by manufacturers and retailers, including small retailers who tend to sell at the pre-ticketed or suggested price. The wording was thus consistent with the small business preference to weaken the ban on resale price maintenance. In sum, there were provisions in the Stage 1 amendments supportive of small business, although the briefs submitted during the amending process did not necessarily reflect such support. Whether the Stage 1 amendments actually assisted small business requires an evaluation of the post-1976 period, which has yet to be undertaken.

The Petroleum Inquiry

A recent enquiry by the Director, now before the RTPC as a Section 47 general enquiry, concerns the petroleum industry. The Director's report summarises the Director's

concern about the nature and extent of competition in the industry (Director, 1981). It is worded in a way which makes the major (large) petroleum companies appear as defendants. In fact, they are not defendants, because the Director decided not to pursue charges under the Act, and this is the reason for a general enquiry being undertaken.

The Director's report identifies the problems faced by small firms as competitors and customers of the large integrated oil companies. Many of these problems concern questions of distribution, and are presented by organisations such as the Consumers' Association of Canada, the National Automotive Trade Association (NATA), and the Canadian Federation of Independent Petroleum Marketers (CFIPM).

The issues identified by the Consumers' Association in their opening statement include:

a) The existence of excess capacity in the retailing of gasoline leading to increased costs and prices.

b) The restrictions on the growth of the independent marketers arising from the marketing practices of the majors.

c) The influence of vertical integration amongst the majors on the pricing undertaken by company-owned stations.

d) The failure of marketers to provide information to consumers. Information is readily available only regarding the price of regular gasoline. In the U.S.

certain states require that the prices of at least four types of gasoline be publicised.

NATA represents amongst others, about 6000 gasoline retailers, and a major concern centers on the question of price discrimination as practised by the majors. The CFIPM represents independent marketers who consider themselves to be the injured party in the RTPC inquiry. They are concerned with the unfair trade practices of the majors, from whom they have tried unsuccessfully to obtain relief. Their appeal is now being made to government, but their members are fearful of retaliation by the majors.[1]

The major oil companies are represented by lawyers from major law companies in Canada. The small companies which are affected by the conduct under investigation are also represented, but there is a disproportionate amount of resources backing the large relative to the small firms.

5.4 SELECTED ASSOCIATION BRIEFS AND OTHER REPORTS

There have been numerous opportunities in recent years for small and big business to state their views to Federal and Provincial governments on the topic of competition policy. The Canadian Federation of Independent Business (CFIB) represents over 55,000 firms, almost all of which are small. The CFIB's political influence comes from its number of members and the

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[1] Stated in the opening remarks of J. Conrad on behalf of the CFIPM before the RTPC, October 19th, 1981.

votes which they represent as opposed to the large sums of money available to large firms. In addition, the CFIB has a well organised advocacy program, which ensures that its views are communicated to bureaucrats and to politicians. Another group representing small firms is the Ontario Federation of Agriculture, whose briefs provide a good examination of the competitive relationships of farmers with large food processors, and the latter with small retail operations. Other associations with a strong small business contingent include the retail merchants, gasoline retailers, investment dealers and the plumbing and heating firms.

5.4.1 Canadian Federation of Independent Business

In 1977, the CFIB, with 42,000 members at the time, appeared before the House of Commons Standing Committee on Trade, Finance and Economic Affairs to discuss Bill C-42, an Act to Amend the Competition Act. Bill C-42 contained a version of the Stage II amendments to the Combines Investigation Act. Highlights of the CFIB's submission are contained in Exhibit 5-4 and deal with monopolies, price discrimination, oligopolies, class action suits, and a review process.

At the outset, the CFIB declared in their brief that,

> The Federation believes that strong competition laws are necessary to make the free market system work and that the government must seek to implement a Small Firms' Policy for Canada by development of other policies as well as competition policy (p. 1).

The conception of the 'free market system' is one in which

EXHIBIT 5-4

Highlights of the Submission of the CFIB to the House of Commons Standing Committee on Trade, Finance and Economic Affairs to Discuss Bill C-42, An Act to Amend the Competition Act, June 22, 1977

(1) Monopolies, including government-sanctioned monopolies, possess sufficient market power to impose costs on the economy in terms of poor performance. Therefore, the Federation has recommended that all Crown corporations and regulated industries be brought under the provisions of the bill. The proposed Act would exclude those Crown corporations from the Bill.

(2) Strong action should be taken against price discrimination and predatory pricing, the two most common tools with which larger firms build offenses against smaller firms. Only in those instances where price differentials can be justified by cost differentials would price discrimination be permitted.

(3) Members of the Federation favour a freely competitive market wherever possible. Only where no other solution is available should government intervene in the marketplace. Accordingly, the Federation opposes the proposal to allow government regulation of industries where a small number of firms control supply of an article or service. The solution, the Federation stated, "is for the government to assist more owner-managed firms to enter the market. This can be done by strong competition policy which prevents artificial barriers to entry being erected by a dominant firm" or co-ordinated group effort.

(4) The Federation opposes introduction of class action suits. "The Cost to business and ultimately the consumer in permitting class actions appears to outweight any benefits gained therefrom" even though the Act includes safeguards to protect against some of the abuses found in the United States under similar legislation.

(5) The Federation encourages the federal government to understand that "much of bigness in our society is really a number of small plants under common ownership." Therefore, the members of the proposed Competition Board must understand that "bigger does not necessarily mean more productive or more efficient." In addition, the Federation emphasizes "the need for high-calibre appointments to the Competition Board."

Exhibit 5-4 cont'd.

(6) The Committee was urged to "include in the legislation some method of parliamentary review of the working of this legislation every year or every second year." Moreover, the Federation "strongly opposes any attempt to include an appeal to Cabinet in the Bill because the arguments which would be made to over-ride the competition issue would be made in private and not in a public forum."

SOURCE: Canadian Federation of Independent Business, Press Release, June 22, 1977.

government intervention through competition policy is acceptable, and government intervention through the development of a new set of small firms' policies is favoured. Freedom is thus viewed as being consistent with intervention in the interests of small firms, through tax policies and other financial incentives, regional development policies and energy policies. The rationale for this intervention is that,

> In order to have a healthy competitive economy, there must be a constant flow of new entrants into all markets, except for the most capital-intensive industries (p. 5).

Six competition policy issues are dealt with in the seventeen page brief, regulated industries, price discrimination, oligopolies, class actions, mergers, and the Competition Board. However, eight of the pages are devoted to the topic of price discrimination, and it is clear that small business' major preoccupation is with the competitive aspects of distribution. The CFIB notes the support given to the Robinson-Patman Act in the U.S. in the face of its critics, the desirable amendments to the price discrimination law in Australia concerning cost-justification, the U.S. Court of Appeals decision in U.S. vs. United States Gypsum Co. 797ATRRF-1(CA3-1977) which argued that an effective price discrimination law aids oligopolies (a position opposed by the CFIB). The CFIB suggests that the criminal section on price discrimination be retained, and amended so that the buyer who knowingly participated in price discrimination is made a party to the offence as well. The Federation also states, with no empirical or theoretical support,

that in many cases there are no economies in large volume purchases.

The main concern of the CFIB regarding price discrimination is that large firm buyers have an advantage over small firm buyers, due to suppliers selling at a lower price to large firms. The Federation is ambivalent about whether a meaningful cost-justification argument can be administered. The ability to engage in price discrimination is recognised as being due in part to the oligopolistic structure of suppliers and their customers, but the Federation argues against amendments which would allow the government to control oligopolies. The apparent inconsistency in these two positions, on price discrimination and oligopolies, can be explained as follows. First, the positions taken in the Brief result from polling the membership of the CFIB. Members' answers may be inconsistent, or some individual members may have been consistent, but the total of all members results in an overall inconsistent response. Second, the CFIB dislikes government intervention, unless it aids its members. Thus any mention of regulating oligopolies causes the membership to focus on regulation, which it dislikes, rather than on the oligopolies which may affect it adversely. And third, the Federation suggests that if small firms are protected against unjustified price discrimination at an early stage, oligopolies will not develop and therefore regulation will not be needed. This last argument suggests a belief that the clock can be turned back several decades and the present level of concentration ignored.

One further point is emphasised by the CFIB. If there is not a fast procedure to deal with predatory pricing, then the affected firm will be suffering from rigor mortis by the time remedial action is applied. The procedure for administering competition policy works against the survival of small business in cases involving unfair trade practices. The 1976 Stage 1 amendments to the Combines Investigation Act recognised this problem by inserting Part IV.1 on reviewable trade practices which would be handled by the RTPC. However, the experience to date is that very few cases have been brought under Part IV.1, two in 1979 and three in 1980 according to the Director's Annual Reports, (and one in 1980 is the same as one in 1979). After five years, there is a written decision in only one case involving a complaint about exclusive dealing involving Bombardier Ltd. and the sale of snowmobiles. This inquiry was commenced in November 1977 and the decision was reached three years later.

Two questions need to be examined regarding the evaluation of Reviewable Trade Practices under Part IV.1. First, can the process of collecting information regarding the alleged practice be speeded up? And second, can the process of evaluating the evidence be simplified so that a decision can be reached before the affected firm is forced into bankruptcy? Five years is an appropriate interval to examine the impact of the Stage 1 amendments, a part of which should include their impact on small firms.

5.4.2 Ontario Federation of Agriculture

The Ontario Federation of Agriculture (OFA) has made detailed representations on the subject of discounts and allowances in the food industry. The OFA's interest is in the trade practices and competitive structure of grocery distribution in Ontario, and in particular the circumstances faced by suppliers, many of whom are small, in dealing with the large grocery chains.

The OFA notes that food manufacturers and suppliers have been reluctant to divulge details regarding sales arrangements discounts and allowances. One concern is possible retaliation by the major buyers. Consequently the OFA proposes that information collected by questionnaires will not be a good way of obtaining reliable data. For the purposes of the 1979 Ontario Royal Commission on Discounts and Allowances, the OFA asked for detailed information on the discounts and allowances granted by suppliers to large and small grocery chains and to small independent retailers.

> This practice of rebates regardless of its legality, calls for a full inquiry into its implications for the food trade. The outstanding issue is the importance of sometimes large differentials between the discount levels of the largest and most aggressive chains and, on the other hand, those of independent retailers, affiliated independents, and even of the less aggressive or relatively smaller chains. The effect of these differentials is that the chains with the largest sales and most artful buyers are able to buy goods at a lower net cost than their rivals. The levels of discounts vary greatly from one chain to another on certain products, as will be shown below. On some other products, the total discounts and allowances are substantially higher for

> the leading chains generally than for independent retailers and voluntary buying groups. On still other products the voluntary groups have negotiated discounts totalling about the same as the chains but the net price to the unaffiliated independent is substantially higher than to his competitors (Brief to Royal Commission, 1979, p. 4).

The OFA argues that the Royal Commission should determine whether the differential discounting practices are associated with real economies associated with transactions and transportation costs of "contacting buyers, loading, transporting, and unloading the product, invoicing buyers, etc."

The Royal Commission examined these issues in the Report and in two of its seven conclusions stated

a) It appears that there is no significant difference in the level of rebates granted by small or large processor/manufacturers. In other words, the rebate system is not a resolution of market power that favours either large or small processor/manufacturers.

b) It appears that there is no significant difference in the level of rebates received by small or large retailers. In other words, the rebate system is not a resolution of market power that favours either large or small retailers.

In recommending that the Ontario government establish a forum, outside government, to mediate problems between the various levels in the food industry, the Royal Commission was suggesting that discussion would be an adequate remedy for the problems and that no further inquiries should be conducted (Royal Commission, 1980, pp. x-xii). The Royal Commission examined a number of aspects of the Canadian and U.S. laws regarding price discrimination in the course of their inquiry.

The OFA has taken issue with some of the Royal Commission's empirical findings, on the grounds that a biased sample of respondents was questioned on the issue of discounts and allowances. The issue does not appear to be closed, and the representatives of small firms still feel there is a case to be discussed.

5.4.3 Economic Council of Canada

The Economic Council of Canada has published a report on the impact of regulation on small business, based mainly on 100 interviews with small firms in Canada. The general conclusion was that small business was not being 'crushed by economic regulation', but that, relative to larger firms, small firms could not exert the same influence with the regulators at either the bureaucratic or political levels (Economic Council, 1981, pp. 1, 15).

The study reveals some interesting small business traits,

> ...many small business owners did not distinguish between economic regulations imposed by governments, restrictions imposed by other large organizations, or the taxation system they were subject to (p. 1).
>
> Probably all of these smaller firms operated in non-compliance of some economic regulation out of ignorance (p. 2).
>
> With regulations that require no paperwork or regular visits by inspectors, the level of awareness and compliance is considerably lower (p. 3).

An alternative conclusion might be that small business would be 'crushed by economic regulation' if they were aware of the regulations and complied with them, or if they were forced to

comply with them. However, in many instances the cost of compliance (a type of transaction cost) is so high that regulations are unevenly applied. Larger firms may be more likely to comply with regulations than small firms, because they may be more aware of the regulations, and more visible if they do not comply. On the other hand, larger firms may, through lobbying and discussions with officials, be able to reduce the impact of regulations on their costs of production, but this lobbying is not itself a costless process.

Many of the issues which are of concern in the food processing industry are repeated in the petroleum industry, e.g., price discrimination, predatory pricing, consignment sales, temporary allowances and various types of rebates and allowances which are altered from time to time. In the petroleum, as in the food processing industry, this concern is expressed by small firms about their dealings with larger firms. It is not a new concern, because there are earlier reports by the Restrictive Trade Practices Commission on the marketing of gasoline, tires, batteries and accessories.[1] An examination of other industries would show a similar concern for the effect of distributive arrangements on small firms. For example, Canadian book and periodical publishers have commented on this topic (Royal Commission , 1972).

[1] These inquiries are reviewed in Director, (1981), pp. 205-209.

The thrust of these industry-specific inquiries is on the relationship of small to large firms in vertical marketing situations. There are two sets of factors to consider in further research on this topic. The first is the literature which has been developed in recent years on predatory behavior and on transactions costs (Williamson, 1977; Areeda, 1975; Joskow, 1979); the second is the impact of information technology on the administration of vertical distributive arrangements. Technological change may present opportunities for small firms in some instances, and promote scale economies in others, which may alter the firms' competitive position.

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CHAPTER 6

SUMMARY AND CONCLUSIONS

6.1 SMALL FIRMS AND THE DEVELOPMENT OF COMPETITION POLICY

In 1888, a Select Committee of the House of Commons was established to inquire into alleged combinations in restraint of trade. The commodities examined included sugar and groceries, coal, watch cases, barbed wire, binder twine, agricultural implements, stoves, coffin makers and undertakers, oatmeal millers, egg dealers, barley, and fire underwriting (Ball, 1934, p. 3). Small as well as large firms were parties to these combinations, many of which were organised through trade associations. A later study also noted the way in which small firms organized themselves in trade associations, in order to control business activity, "where producers are small, more numerous and difficult to control, the trade association form of organization has frequently been used" (Reynolds, 1940, p. 12). Subsequent combines cases were notable for the fact that some type of trade association facilitated the establishment and maintenance of the agreement, such as Container Statistics in R. v. Container Materials (1942) and the Canadian Pulp and Paper Association in R. v. Howard Smith Paper Mills Ltd., et al. (1957).

Like their professional brethren in the U.S., Canadian economists were not critical of these associations. Professor W.J. Ashley of the University of Toronto, writing in 1890, defended the Dominion Wholesaler's Guild on the grounds that

it prevented the "evil of price cutting" and the "excessive multiplication of small shops" (Ball, 1934, p. 6).

Small business appeared on both sides of the issue. For example, as critics of these early combinations, small retailing firms, which were not members of the Dominion Wholesaler's Guild complained about their disadvantageous position as purchasers vis-à-vis the larger wholesalers, while small wholesalers, who were members of the Guild, combined in order to create bargaining power in their dealings with larger manufacturers.

Reynolds states that

> the numerous small, unorganized manufacturers are at a great disadvantage in bargaining and the buyer is able within limits to dictate price, specifications, delivery dates and other terms of the bargain. There exists, indeed, a strong tendency for manufacturers in these industries to become merely contractors making goods to order for large retailers (Reynolds, 1940, p. 29).

This concern with small firms in vertical distribution arrangements, especially in the food and grocery trade has been a continuing topic of study and discussion in Canadian competition policy. For example, the Restrictive Trade Practices Commission (RTPC) published a report in 1958 entitled, Study of Certain Discriminatory Pricing Practices in the Grocery Trade, and the Ontario Government published a Report of the Royal Commission of Inquiry into Discounting and Allowances in the Food Industry in Ontario in September 1980. In the petroleum industry, distribution arrangements between large refiners and small distributors have been, and are now the subject of examination. The Petroleum Inquiry (1982) before the RTPC is also examining this issue.

The concern of small firms was reflected in the passage of the legislation dealing with price discrimination and unfair trade practices in 1935, while the prohibition of resale price maintenance in 1951 was viewed by small firms as being contrary to their interests (see Sections 5.2.1 and 5.2.2). The passage of the Stage 1 amendments dealing with reviewable trade practices, such as exclusive dealing, tied selling, market restriction and refusal to supply was made with the interests of small firms in mind. However, there has been relatively little activity under the sections of the act dealing with both unfair trade practices and reviewable trade practices (see Section 5.2.3).

The history of competition policy to-date can be shown to have had strong elements of support for small business in the intent of the legislation, although less support in its application. Some have argued that certain aspects of competition policy, especially price discrimination legislation, tend not to promote competition because they are overly protective of small business (see Section 5.2.2).

This overview of the history of competition policy suggests the following areas for further research:

1. AN EXAMINATION OF THE VERTICAL COMPETITIVE RELATIONSHIPS OF SMALL FIRMS AS SUPPLIERS TO AND CUSTOMERS OF LARGE FIRMS IN SELECTED INDUSTRIES.

Although this topic has been studied previously in a number

of industries, the issues regarding predatory behaviour have not been resolved. Two recent reviews of industrial organization literature reach this conclusion:

> Modern scholarship, I may observe, has raised strong doubts about the frequency of use of predatory competition, and has by no means resolved the theory of its operations (Stigler, 1982, p. 7).

and,

> the welfare effects of increasing the stringency of the definition of predatory behaviour are far from unanimous (Spence, 1981, p. 57).

The use of case studies is viewed as part of the analytical approach to the "new industrial economics" (Schmalensee, 1982, p. 25). Spence states

> My instinct as an economist is to study industries on a case-by-case basis, applying and adapting models as appropriate. For those of us who do this kind of work, the differences among industries sometimes seem more important or interesting than the similarities. And thus we are uncomfortable with general rules. That, of course, is not very useful to courts or litigators, who require some general principles or rules on which to hear and argue cases (Spence, 1981, p. 58).

2. AN EXAMINATION OF THE ACTIVITIES OF TRADE ASSOCIATIONS AS THEY AFFECT THE OPERATION OF COMPETITION POLICY.

Section 32(2) of the Combines Investigation Act makes certain provisions for the operations of trade associations, but there has been no overall study of this topic in Canada. In contrast, in the U.K., information agreements have been a topic of concern, and since 1968 have been required to be registered

(Scherer, 1980, p. 525); and in the U.S., the anti-competitive aspects of trade associations receive continuing attention (Stocking, 1954; Scherer, 1980, pp. 521-525). This issue is precisely the object of Adam Smith's oft-quoted remark that "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public or in some contrivance to raise prices". Smith did not advocate the abolition of trade associations, but he did advocate that the government "ought to do nothing to facilitate such assemblies, much less to render them necessary". In Canada, there is a need to know what trade associations do, before we know whether government policy is facilitating their operation in a pro-competitive manner.

3. AN EXAMINATION OF THE REASONS FOR THE SMALL NUMBER OF INQUIRIES MADE UNDER THE 'REVIEWABLE TRADE PRACTICES' SECTION OF THE COMBINES INVESTIGATION ACT.

This section was introduced in 1976 in order to deal with distribution arrangements, many of which affect small firms.

Different parts of the Federal government show different degrees of support for competition policy. Those parts which are critical of competition policy tend to be associated with particular industry sectors such as agriculture and transportation. The history of competition policy also reveals instances

where government has been supportive of larger firms on the grounds that it is easier to implement policies when dealing with a few large rather than many smaller firms (see Section 5.2.1).

Judged by the jurisprudence which has developed, especially regarding conspiracies, mergers and monopolies, and by the difficulties encountered in amending the Combines Investigation Act in recent years, a case can be made that there is not the concern in Canada, that exists in the U.S., over the economic and political power of big business. Antitrust policy in the U.S. has developed partly in response to such a concern, and small business has been one beneficiary of this policy.

An alternative case can be made that there has been an ongoing concern over the power of big business in Canada, but it has been reflected and responded to in other ways, because of the way in which the jurisprudence has developed in the Combines Investigation Act. For example, there has been a Royal Commission on Corporate Concentration (1978), a Royal Commission on Newspapers (1981), a Senate Report (1970) on concentration of mass media ownership, inquiries into profits in the steel industry (Steel, 1974) and in banking (1982),[1] and research inquiries by the RTPC into vertical integration in telecommunications and into the petroleum industry. Acceptance of this view would mean that in order to understand the administration and operation of competition policy in Canada, it is

[1] A House of Commons Committee inquired into banking profits in the summer of 1982.

necessary to take a wide rather than a narrow view of competition policy, and within this broader view determine the implications for small as well as larger firms.

The Bureau of Competition Policy records a large amount of information on the day-to-day administration of the Act, which provides useful data for analysing the problems faced by small firms. In particular, the Daily Register, Merger Record and the Complaints filed with the Marketing Practices Branch contain such information. Not only the data, but the officials who handle these data are an important source of information on the administration of competition policy (see Section 5.3).

The Merger Record provides information to determine the reasons for the disappearance of firms through mergers. Information recorded by the Foreign Investment Review Agency could also be useful in explaining the reason for mergers, and this information has the added advantage of injecting the dimension of foreign ownership into the examination of industrial organization in Canada.

These findings lead to the following recommendations.

4. ANALYSIS OF COMPETITION PROBLEMS FACED BY SMALL BUSINESS SHOULD BE UNDERTAKEN USING AVAILABLE DEPARTMENTAL AND FIRA RECORDS.

These data may be used to complement the case-by-case industry studies suggested above.

5. AN EXAMINATION OF THE REASONS FOR THE DISAPPEARANCE OF SMALL FIRMS IN MERGERS IN TERMS OF FACTORS INTERNAL AND EXTERNAL TO THE FIRM.

The view of competition policy as having been supportive of the interests of small business is not one generally shared by small business. In fact, small business has been ambivalent on the issue (see Section 4.3). In national surveys, conducted by the CFIB in Canada and the NFIB in the U.S., small firms do not indicate that they have significant problems as customers of, suppliers to, or competitors of big business. However, in briefs to Royal Commissions, and government inquiries, and behind closed doors small businessmen state that such problems do exist.

There appear to be two reasons for this ambivalence. First, there is fear of economic retribution from suppliers, customers and competitors if a small firm lays a complaint against a larger firm. Second, the ideology of small business is similar to that of all business, namely a dislike of government bureaucracy, guidelines, regulations and intervention in general. Thus, in order to be openly supportive of competition policy a small firm will have to be supportive of a form of government intervention. Notwithstanding this ideological viewpoint, surveys of the CFIB show that small business can at times favour government intervention, if it appears to be supportive of their commercial interests.

Answers to selected questions in CFIB surveys between 1976 and 1980 related to competition policy issues are shown in Exhibit 6-1. The answers to these questions illustrate the ambivalence of small business to its ideological preferences.

There are a variety of possible reasons why small business has not been supportive of competition policy: the issues are not understood or the policy provisions are unknown; competition policy has not been supportive of small business in intent or application; or fear of retaliation is real and has been experienced.

6. IT IS RECOMMENDED THAT THE ATTITUDE OF SMALL BUSINESS TO COMPETITION POLICY BE EXAMINED, ALONG WITH THE REASONS FOR IT.

In the U.S., the Federal Trade Commission and the Small Business Administration have made a point of publicising the fact that they will advocate and represent the interests of small business in antitrust matters, because of the stated fears of retaliation by larger firms. A similar advocacy campaign may be required in Canada.

In the United States, small business has also voiced its concern over competition with big government. Examples of such competition exist in housing, transportation, and social service (e.g., recreation) programs. Some of the products or services that are designed for government are supplied by government

EXHIBIT 6-1

CFIB; SELECTED MANDATE ISSUES

(Vote in Percentages)

February 1976 - Question 2

2. Are you for or against the collection of triple damages by businessmen injured by violations of the Combines Act?

Significant amendments to the Combines Investigation Act were proclaimed Jan. 1, 1976. Now an injured businessman will be able to sue for losses suffered as a result of certain violations of the Act. Injured businessmen previously had no right under the Act to sue in court for such damages.

Violations covered in the amended Act include such cases as one firm conspiring to injure another firm and unduly limiting competition. Other relevant sections cover such topics as price discrimination and predatory pricing.

The injured businessman has to prove to court the amount of actual loss he has suffered. In the USA, for similar violations of anti-trust, triple damages are potentially available to injured parties.

Further amendments to our Combines Investigation Act are under consideration at present.

Arguments for: The possibility of triple damages encourages enforcement of anti-trust or anti-combines laws in the private sector. A potential award of only single damages is not a real deterrent, as a defendant can tie up the case in court. Potential of triple damages encourages fast out-of-court settlements, with recovery of real costs. Independent businessmen in the USA feel that a triple damage provision is like a basic right in their survival against unfair competition.

Arguments against: The potential of triple damages could possibly encourage nuisance suits and lawsuits on dubious grounds, and could be used to harass. Defendants might decide to settle whereas they might otherwise be prepared to fight the case. The penalties for anti-trust offences should not be more punitive than those for other offences in our society. Aggressive business tactics might be inhibited. Single damages are sufficient remedy for the injured businessman.

FOR - 52%, AGAINST - 37%, NO OPINION - 21%

May 1977 - Questions 1-3

(1) Are you for or against suppliers being free to give customers who purchase large quantities a price advantage that cannot be justified by cost savings?

There are many economies in purchasing in bulk quantities; however, volume discounts can be unnecessarily generous, discriminating in fact against small purchasers. For example, a supplier selling 200 units to customer A at 4 locations might not deserve a lower price than customer B who received 100 units at one location.

Arguments for: Suppliers should be able to charge whatever price the market will bear. Achieving price advantages is one of the functions of good purchasing.

Arguments against: Small purchasers lack the market power to influence selling prices. If a price advantage cannot be justified, it is a form of unfair competition.

FOR → 47 AGAINST → 49 NO OPINION → 4

(2) Are you for or against greater control over industries where the supply of an article or service to a market is controlled by a small number of firms?

These industries are often referred to as oligopolies or joint monopolies (e.g. steel, oil, cement, light bulbs, etc.). The products of these firms tend to be homogeneous. Under certain circumstances, a new board could prohibit these firms from carrying out similar pricing or other marketing strategies. It would not be necessary to prove that the firms had conspired together.

Arguments for: In oligopolies there is virtually no competition in price related matters. There is a tendency for wages and prices in highly concentrated industries to be a good deal less sensitive to changes in economic conditions. Oligopolies create artificial barriers to entry. Historically, governments have regulated monopolies because competitive forces cannot work and similar reasoning should apply in the case of oligopolies.

Arguments against: Where companies are supplying homogeneous products as described above, firms must sell at identical prices or the customers will purchase from the company selling at the lower price. If one firm adopts a successful marketing strategy, others will want to copy it. The government should only intervene when the companies conspire. The government is attempting to intervene in the normal workings of the marketplace.

FOR → 36 AGAINST → 56 NO OPINION → 8

(3) Are you for or against bringing regulated enterprises under the new Competition Bill?

Examples of regulated enterprises are the professions, trucking, public utilities, telephone services, and insurance. These groups are affected to some extent by the present law. However, in the future, unless specifically exempted by legislation, regulated enterprises would be subject to the same competition rules as all other enterprises.

Arguments for: The hidden costs to the economy of poor regulatory performance justify the application of principles of competition policy. Regulated industries would serve the public more efficiently by allowing competitive market forces to operate.

Arguments against: Regulated industries could find themselves in the position of complying with one government administrative board's instructions which at the same time could cause them to be in violation of the provisions of the new Competition Bill.

FOR → 52 AGAINST → 31 NO OPINION → 17

March 1979 - Question 3

Are you for or against the prescreening of large mergers as proposed in the recent federal competition bill?

ill C-13 is a bill designed to strengthen competition law. One f its key provisions is the power provided to a Competition oard to examine proposed mergers and acquisitions if the combined market share of the two companies involved xceeds 20%. Refusal would be based on a "substantial lessening of competition". Approval would be granted if improvements in efficiency resulted from the new merger or acquisition. Recent merger activity in Canada has aroused new interest in Bill C-13 which passed first reading in Parliament, but was allowed to die on the order paper.

rguments for the prescreening of mergers: It is difficult to unscramble harmful mergers after they have been arranged. Excessive concentration of power in business can adversely ffect suppliers and customers. Lack of market competition eads to economic inefficiency and can stifle innovation.

Arguments against the prescreening of mergers: A government board is often incapable of making complex decisions about efficiency. Some large corporations in Canada are still small by international standards and are subject to international, if not domestic, competitive forces.

FOR 12 | AGAINST 25 | NO OPINION 15

October 1979 - Question 3

Are you for or against suppliers imposing exclusive dealing restrictions on their customers?

"Exclusive Dealing" in general refers to product distribution arrangements where the supplier attaches restrictions on distributors regarding their ability to sell only that product, or restricts the sale or purchase of competitors' products. Often, exclusive dealing arrangements are restricted to local markets and do not cover the entire country. Some of these latter problems are dealt with under the market restriction provisions of The Combines Investigation Act. Exclusive dealing in The Combines Investigation Act is a practice reviewable by the Restrictive Trade Practices Commission and is dealt with on a case by case basis.

Arguments for suppliers imposing exclusive dealing restrictions: Exclusive dealing arrangements can provide the supplier a guarantee of sales and profitable production. Similarly, it can guarantee to a distributor a reliable and adequate source of supply. Both of these benefits can be of significant benefit to businesses about to embark on expansion. Exclusive dealing can lead to more efficient business by utilizing economics of scale.

Arguments against suppliers imposing exclusive dealing restrictions: Where exclusive dealing is extensive, it can hurt competition by denying suppliers distribution outlets. This harms or prevents competition at retail and distribution levels. Potential suppliers are often faced with the need to set up a separate distribution system and bear greater costs in order to market their goods. Exclusive dealing arrangements can create barriers to entry to certain markets.

FOR 22 | AGAINST 62 | NO OPINION 16

September 1980 - Question 2

(2) Are you for or against restricting volume discounts to match only real, provable economies?

Giant retailers combine the purchases of their subsidiaries nationwide to bargain for annual volume discounts from manufacturers. Suppliers have little choice but to agree to the discounts, as retail chains control so much of the retail market. The rebate levels can go far higher than actual cost savings.

Arguments for restricting volume discounts to match only real, provable economies: The volume discounts are unfair to the small retailer and wholesaler; the large chain distributors can force a price advantage just by their market power. The independent manufacturer often has more difficulty resisting the pressure for discounts than the large national manufacturer. A fair and workable solution is to allow volume rebates only to the extent that actual selling and delivery savings can be shown.

Arguments against restricting volume discounts to match only real, provable economies: This law might discourage some legitimate, competitive price-cutting by suppliers. In a free market economy it is not the role of government to prevent large companies from exercising their advantages. Where this law has been in force (U.S.), it has proven difficult to determine the cost savings of shipping in large volumes. Restricting discounts might encourage more vertical integration by large retailers.

FOR 41 AGAINST 46 NO OPINION 11

October 1980 - Question 3

(3) Are you for or against prohibiting minimum volume orders?

Manufacturers and wholesalers often set minimum volumes below which they will not sell to other businesses. These are usually expressed as a certain minimum dollar volume of business per month or per year. The refusal to sell below minimum volumes is not prohibited either in Canada or in the U.S., but it is prohibited in certain circumstances in some European countries.

Arguments for prohibiting minimum volume orders: Independent distributors or retailers who want to provide a full line of goods to customers often find they cannot purchase needed items in small volumes. The practice makes it more difficult for smaller firms to compete with large chain distributors. Consumers are poorly served by a distribution system that effectively limits choice.

Arguments against prohibiting minimum volume orders: Suppliers lose money delivering small orders and handling special items. If suppliers were required to service small orders and charged the true cost, prices would be higher. Independent retailers can form buying groups and buy in volume to overcome the difficulty. Such regulations would be costly to enforce and restrict the freedom of business.

FOR 38 AGAINST 52 NO OPINION 10

facilities. It has been alleged that some of these products and services could be supplied cheaper by small business, and that where small business competes with government agencies for government business it is at a competitive disadvantage.

Governments in Canada, federal and provincial, are even more actively involved in the Canadian economy, particularly through crown corporations, government owned corporations and mixed-enterprises. While the competition problem with government may be one of perception, it is visible and concern with this type of competition has surfaced in interviews with small business.

7. RESEARCH SHOULD BE UNDERTAKEN TO IDENTIFY THOSE COMMERCIAL AREAS AND SECTORS WHERE GOVERNMENT IS DIRECTLY INVOLVED IN THE PRODUCTION AND SALE OF GOODS AND SERVICES, AND TO ASCERTAIN WHETHER SMALL BUSINESS HAS BEEN PLACED AT A COMPETITIVE DISADVANTAGE BECAUSE OF SUCH ACTIVITIES.

6.2 PROBLEMS FACED BY SMALL FIRMS

Small firms represent a large and diverse group, ranging from businesses such as independent contractors and family-owned retail establishments, to wholesalers and manufacturers of sophisticated computer hardware. What constitutes a small business involves a degree of subjective judgement. The criteria employed is both varied and often hard to standardize, such as assets, sales, income, number of employees, type of ownership or management structure (see Sections 2.7.1 and 2.7.2).

Different governments use different criteria to define small business, depending on the purpose at hand, for example, statistical collection requirements, behavioural analysis or the formulation of public policy. Although all governments use summary measurements, many employ standards which differ with industry sector. The definitional and measurement problem of small business needs to be recognized explicitly in any analytical work undertaken on the small firm sector and in discussions of policies aimed at small business. At present there are significant differences between the meaning given to the term 'small firm' within Canada and between Canada and other countries (see Section 2.2.3).

The statistics collected on small firms in Canada provide a good starting point for further analysis (see Sections 2.3.1 and 2.3.2). Such analysis should become more industry specific to examine the efficiency of small firms, their financial structure and the reasons why small firms disappear in mergers. The dynamic opportunities which may occur because of market situations generated by the growth of firms should be explored, including the nature and extent of the opportunities, specifically those factors which affect the start-up of firms as competitors with, suppliers to, or customers of, large firms.

8. AGGREGATE STUDIES OF THE CHANGE IN THE SIZE OF THE SMALL FIRM SECTOR SHOULD BE UNDERTAKEN WITH A VIEW TO EXAMINING THE EFFECT OF CHANGE ON AGGREGATE AND INDUSTRY CONCENTRATION.

Management Competence

The management literature on small business suggests that the major problems encountered by small firms in the marketplace has little to do with "unfair" competitive practices of big business. The key cause of the high failure rate among small firms is attributed to weaknesses in the management capability of small business. Activities within the management function that exhibit major weaknesses run the gamut from deficiencies in the areas of planning, recruiting and delegating, to accounting, finance and marketing on the part of the entrepreneur as manager (see Section 4.2). According to Dun & Bradstreet, it is "incompetent management" that leads to business failure (see Section 4.1).

This explanation is under increasing attack, both in terms of what constitutes failure and the causes that underlie it. From the perspective of the CFIB membership, the 1981 problems facing small business included "high interest rates, inflation, labour, slower business and government regulation" (see Section 4.3). The difficulties were seen as largely external to the firm, and not internal as is the case with Dun & Bradstreet and much of the management literature.

This difference in perception and interpretation can be gleaned from the following example. Critics of the chartered banks often argue that small business lacks the bargaining power to obtain a fair deal from the large and powerful banks, or that they are subject to lending policies that are too conservative and restrictive to provide the amount of funding that is required. Bankers, on the other hand, often argue that many small business

loan requests are economically undeserving, or presented by owner-managers who do not have the financial understanding to build a strong case or the financial management expertise to operate a business profitably.

The explanation for the financial plight of small business in 1982 is not difficult to understand. Most small firms rely heavily on short-term bank loans for their capital structure. The debt equity ratio is high as well. This reliance on short-term debt increases the cost of carrying receivables and makes these firms sensitive to slow payment. Many small businesses operate with a negative net worth and are technically bankrupt, while others rely heavily on loans from relatives and friends. Thus, the heavier reliance by small business than large firms upon bank loans for capital contributes to higher interest rates and costs (in relative terms) for small business.

One of the problems associated with analyzing the managerial performance of small business is the assumption that the management principles employed in big business can be applied to small business, except for the fact that it would be practiced on a smaller scale recognizing differences in sales, assets and employees. This viewpoint has come under attack.

> ...the very size of small businesses creates a special condition--which can be referred to as <u>resource poverty</u> --that distinguishes them from their larger counterparts and requires some very different management approaches.
>
> Resource poverty results because of various conditions unique to smaller companies. For one thing, small businesses tend to be clustered in highly fragmented industries--wholesaling, retailing, services, job-shop manufacturing--that have many competitors which are

> prone to price-cutting as a way to build revenues...
>
> Also, the owner-manager's salary in a small business represents a much larger fraction of revenues than in a big company, often such a large fraction that little is left over to pay additional managers or to reward investors. Similarly, small businesses cannot usually afford to pay for the kind of accounting and bookkeeping services they need, nor can new employees be adequately tested and trained in advance.
>
> In addition, external forces tend to have more impact on small businesses than on large businesses. Changes in government regulations, tax laws, and labor and interest rates usually affect a greater percentage of expenses for small businesses than they do for large corporations (Welsh and White, p. 18).

There is little that competition policy can do directly to deal with the problem of resource poverty. Nonetheless, there are certain areas which impinge on this problem and complicate the difficulties facing small business in the marketplace. For example, there is the problem of unequal factor price by firm size.

9. RESEARCH SHOULD BE CONDUCTED TO DETERMINE THE PRICES PAID BY LARGE FIRMS COMPARED TO SMALL. THE AIM WOULD BE TO SEPARATE OUT PRICE CONCESSIONS BASED ON SAVINGS TO SUPPLIERS DUE TO VOLUME AND THOSE BASED ON THE EXERCISE OF MONOPOLY OR MONOPSONY POWER.

Small-volume buyers generally have less leverage to extract price concessions, freight absorption, and other special considerations. For this and related reasons, certain small firms, particularly in the retail field have elected to establish buying groups. One such example is CAP Appliance Purchasers Inc. The buying process has been described as follows:

> The store orders merchandise from the supplier for shipment to his store on CAP Inc. purchase order. The invoice cites CAP Inc. as the purchaser and refers to store (#4). After checking the goods and the invoice, the store forwards a copy of the invoice to [CAP Inc.] office for payment. CAP Inc. purchases from the supplier, the stores act as agents for CAP Inc (Coker, p. 7).

Management at CAP Inc. contends that it has achieved significant price concessions for its member stores by negotiating as a buying group with its suppliers. According to the lawyer who helped incorporate CAP Inc.

> ...the sole purpose of forming a buying group covering certain appliance dealers in Ontario, and at the time of formation were essentially dealing with General Electric Appliances. The main purpose of the formation of that company was to take advantage of volume purchases from General Electric Company in order to be entitled to the rebates which would develop and the pricing that would arise from volume purchases (Mackay, pp. 1-2).

Other benefits include an "inventory sharing system" allowing member dealers to draw on each other's inventory thus lowering inventory costs; and lower credit card charges. Future areas for cost reduction initiatives include insurance, sales promotion, transportation and market research (Coker, p. 9).

The formation of buying groups is not limited to retail merchandising and may draw its membership from wholesalers, manufacturers, professionals, etc. Lawyers who help to structure such

groups normally advise the prospective members about those activities that may contravene the Combines Investigation Act. For example, all members in the buying group must be kept on an equal basis to avoid contravening Section 34 of the Act, re: member purhcases from CAP Inc.; all members must be treated equally with respect to promotional allowances in order not to run afoul of Section 35; and sale prices for products purchased through the buying group should be "suggested" to avoid contravening Section 38 dealing with price maintenance (Mackay, pp. 8-10).

In the context of Stage II Amendments embodied in Bill C-42, there is one amendment to the criminal provisions on price discrimination which is of special significance to small business and the future of buying groups.

> That amendment clarifies the existing law and confirms that a buying group of small businesses which offers to purchase articles of like quality and like quantity under substantially the same terms and conditions of delivery is entitled to the same treatment as is accorded to their large rivals. This encourages small businesses to consolidate their orders where this can be done economically and improves the competitive position of the small firm vis-a-vis its large competitor (Consumer and Corporate Affairs, p. 10).

10. GROUP NEGOTIATION AND PURCHASE OF PRODUCTION INPUTS AS PRESENTLY PRACTICED AND PERMITTED UNDER CURRENT COMPETITION POLICY SHOULD BE EXAMINED.

Another area of difficulty for small business arises from government imposed management burdens, specifically government regulations and government paperwork and record retention requirements. Most government regulatory and reporting requirements include elements of fixed cost. Research in the U.S. has shown these costs to be several times as large for small firms compared to large firms when calculated as added cost per unit produced.

In a speech to a Financial Post Conference on Competition Policy in 1981, the Minister of Consumer and Corporate Affairs observed that:

> The task before us is to set the rules so that businesses in Canada will know what they can and cannot do. In this way they can spend less time worrying about government regulation and more time doing what they do best: producing the goods and services that the Canadian economy requires (A. Ouellet, p. 14).

11. RESEARCH SHOULD BE UNDERTAKEN TO MEASURE THE COST OF COMPLIANCE BY BUSINESS SIZE, THE DEGREE OF COMPLIANCE, AND THE CUMULATIVE COMPLIANCE COSTS BY SIC CODES FOR MULTIPLE REGULATIONS.

Many small firms suffer from competitive disadvantages which can be attributed to narrow product lines, short production runs and inadequate distribution and sales support facilities. The encouragement of inter-firm arrangements involving functional areas of management activity such as manufacturing, research and development, distribution and sales in both domestic and export markets might be one way of dealing with some of the

"resource poverty" problems which afflict many small-sized firms.

In this context,

12. SPECIALIZATION AND EXPORT AGREEMENTS AS CURRENTLY PUT FORWARD UNDER THE PROPOSALS FOR AMENDING THE COMBINES INVESTIGATION ACT DESERVE CAREFUL STUDY FOR THEIR POTENTIAL APPLICATION TO SMALL BUSINESS.

The potential for promoting such agreements among small firms, and between small and large firms may not be great. The personality traits of owner-managers militate against such inter-firm arrangements. Through the pooling and sharing of resources, and the specialization of tasks in such areas as marketing and production, the parties to the agreement would have to give up some management control and autonomy. This runs contrary to one of the basic forces which motivate entrepreneurs--to be independent, i.e., "being one's own boss".

Other reasons which tend to limit the establishment of such agreements involve the economic risks associated with specialization. These risks include both supply and demand implications, which may arise from the potential impact of changing technologies and consumer buying preferences.[1] An important point to note is

[1]For a discussion of this topic see H.E. English, "Specialization and Export Agreements in Canada: Retrospect and Prospect"; K. Stegemann, "The European Experience with Exempting Spcialization Agreements and Recent Proposals to Amend the Combines Investigation Act"; and W.L. Fugate, "Specialization and Export Agreement under the Proposed Law" in J.R.S. Pritchard, W.T. Stanbury and T.A. Wilson (eds.), Canadian Competition Policy (Toronto, Butterworths, 1979), pp. 435-502.

that few small businesses are familiar with the provisions of the Combines Investigation Act, including those which could ultimately assist them in overcoming some of their resource poverty problems.

It has been asserted that the Government of Canada has been guided by a number of objectives in its attempt to reform competition policy. One of these objectives is "to prevent abuses of market power and by so doing promote faireness to... smaller businesses" (A. Ouellet, p. 7).

13. RESEARCH SHOULD BE UNDERTAKEN ON HOW BEST TO EXPLAIN THE COMBINES INVESTIGATION ACT TO SMALL BUSINESS IN CANADA, PARTICULARLY THOSE PROVISIONS WHICH ARE DESIGNED TO ASSIST THEM TO COMPETE MORE EFFECTIVELY, AND TO ENSURE THAT THEY ARE NOT VICTIMS OF POTENTIAL MARKET ABUSE.

Relations with Big Business

Federal and provincial governments have actively encouraged large firms to enter into contractual arrangements with small firms in Canada, particularly as buyers of their goods and services. Foreign controlled firms, primarily American, have been a prime target of these efforts. The automotive and joint defence production sharing agreements, government procurement programs and megaprojects are some of the key areas where small and medium-sized firms have been singled out for special attention

and consideration as suppliers of goods and services (see Section 4.5).

Many small-large commercial arrangements resemble informal, if not formal, subcontractual agreements. To ensure that the performance of the small firm (supplier) is consistent with the quality standards of the large firm customer, managerial assistance, direction and co-ordination may be extended by the buyer.

Maintaining an adequate level of working capital is a never-ending dilemma for the small firm. Supplier relationships with large firms is one way of dealing with this problem. Large firms frequently function as suppliers of capital by providing seed capital, helping to finance the purchase of equipment and machinery, extending attractive credit terms in those cases where they also supply some of the inputs, in addition to speeding up payment as buyers of the small firm's output.

Subcontractual arrangements are to be found in all sectors of the economy, and may involve both vertical and horizontal arrangements. While the Ministry of State, Small Business, in 1977 announced that "the federal government will study the feasibility of encouraging closer and mutually beneficial relationships between small and large firms" (Government of Canada, 1977, p. 31), no explicit mention was made concerning the competitive implications arising from such a policy thrust. As previously noted, two years later in 1979, an official of the Small Business Secretariat observed that,

> It is common belief among many in Canada that larger firms have an unbounded voracious appetite to consume, or to force out of business smaller firms. While this happens, of course, the case is usually over-stated. There is growing evidence, in fact, of a trend towards greater mutually beneficial cooperation between larger firms and small through mechanisms such as sub-contracting and private branding; franchising or licensing agencies; managerial co-operation and assistance, quality control, supplier payment agreements and industry productivity institutes (Skelton, 1979, p. 2).

Since public policy appears to be moving in the direction of promoting more small-large firm co-operation for reasons of regional economic development, import substitution and export promotion, it is vital that such arrangements be studied for their possible competitive implications. Market arrangements, between small and large firms are typically asymmetrical and the potential for abuse by the large firm cannot be ignored. The small firm often produces a narrow product line, and the large firm may represent its major market. Thus, there can be extreme dependency in this relationship for the small firm, which may determine its survival.

14. A MAJOR AREA FOR FURTHER RESEARCH IS TO EXAMINE THE NATURE OF THE BOUNDARIES OF FIRMS, WHICH ARISE BECAUSE OF THE USE OF DIFFERENT TYPES OF CONTRACTUAL ARRANGEMENTS. VERTICAL MARKETING RELATIONSHIPS IN ALL SECTORS, BUT ESPECIALLY IN SECTORS WHERE SMALL FIRMS ARE SIGNIFICANT, NEED TO BE EXAMINED.

Franchising

In recent years there has been a significant growth in agency, licensing, subcontracting and franchising arrangements between small and large firms (see Section 4.5). Of the various types of contractual arrangements, franchising has been the most predominant form particularly in the tertiary sector. The benefits to be obtained from such an arrangement are many. For the franchisor, a franchising agreement includes the following two major advantages, first, a quick way of gaining widespread distribution which may be significantly funded by the franchisee. Second, the provisions of the agreement typically spell out the franchisor's expectations concerning the business practices of the franchisee, including the fees and royalties to be paid, as well as the sale of supplies and raw materials.

The benefits are not one-sided. For the franchisee there are a number of advantages to be gained from a franchising agreement. First, there may be easy and successful entry into a business with little prior experience in that industry because of access to the franchisor's knowledge and business system. Second, by pooling resources with the franchisor, the franchisee might be in a better position to obtain the required capital to go into business. An established trade name and the ability to capitalize on the combined power of the franchisor should work to the advantage of a prospective businessman, i.e., the franchisee operator.

Economies of scale and the shared contribution to fixed costs are some of the factors which explain the success of franchising. These advantages, previously available primarily to large multi-outlet firms, are now accessible to the small businesses which elect to be franchisees.

15. THE NATURE OF FRANCHISING ARRANGEMENTS, AND THE EXTENT TO WHICH THE RENTS ARE EQUITABLY DISTRIBUTED BETWEEN THE FRANCHISOR AND FRANCHISEE IS AN IMPORTANT AREA FOR RESEARCH. SUCH A STUDY WOULD ALSO EXAMINE THE EXTENT TO WHICH FRANCHISING AFFECTS BARRIERS TO ENTRY IN VARIOUS INDUSTRIES.

In spite of the mutual benefits to be gained from franchising agreements, numerous abuses and difficulties have been encountered. Premature entry into the market, an uncontrolled expansion, inadequate disclosure to prospective franchisees, and unwarranted treatment of existing franchises are a few of the major abuses encountered. Disadvantageous tying agreements and the threat of franchise termination are two key illustrations of how franchisors may make unwarranted use of their dominant position in the franchising agreement to exact various compliances from the franchisee. Since many provisions found in franchising contracts could individually result in anti-competitive violations, each contract represents a potential bundle of violations, which may reinforce each other (see Section 4.5.1).

In the United States, federal antitrust and trade regulation law problems that have resulted from franchise agreements can be grouped as follows: exclusive franchises and refusals to deal; territorial confinement and customer restrictions; resale price control and price management; and control of product purchases and sales (Rudnick and Wolfe, 1980, p. 29). While there has been a proliferation of laws and court decisions dealing with franchising in the U.S., the situation in Canada is far less complex.

> So far as direct legislation dealing with franchising is concerned, Alberta is the only province in Canada which has enacted franchise legislation and proclaimed such legislation in force. The Franchises Act (Alberta) is modelled closely after California law. It is a disclosure or prospectus type rather than a regulatory type statute and is administered by the Alberta Securities Commission (Zaid, 1980, p. 2).

As for federal legislation, the Combines Investigation Act affects franchising practices and the drafting of franchise agreements under those practices which are subject to review by the Restrictive Trade Practices Commission, and those subject to regulation by direct prosecution under the criminal law of Canada. Refusal to supply, exclusive dealing, market restriction and tied selling are covered under the reviewable practices, while the criminal offences include price discrimination, promotional allowances, price maintenance, pyramid selling, referral selling and misleading advertising.

16. INDUSTRY SPECIFIC STUDIES SHOULD EXAMINE DISTRIBUTIVE ARRANGEMENTS BETWEEN SMALL AND LARGE FIRMS INCLUDING FRANCHISING AND THE ISSUES CONSIDERED AS 'REVIEWABLE TRADE PRACTICES' AND THOSE SUBJECT TO DIRECT PROSECUTION UNDER THE COMBINES INVESTIGATION ACT.

Such a study would focus on a number of questions; for example, does the small firm become an extension of the larger firm when it receives a substantial part of its supplies by way of requirements contract or on consignment? Moreover, what effect would such a commercial relationship have on the small firm's costs and on the price charged to the consumer?

6.3 EFFICIENCY CONSIDERATIONS AND SMALL FIRMS

The competitive aspects of small firms can be considered at three levels, the firm, the industry and the economy as a whole, and in terms of several types of efficiency. Considerations of technical efficiency arise mainly at the level of the firm related to different types of scale economies; internal efficiency is also firm related; allocative efficiency is discussed at the firm and industry levels, as are transaction cost considerations, which affect both the size of firms and the relationship between firms in industries; and dynamic efficiency is related to all three levels, the firm, the industry and the economy as a whole. In some instances, especially regarding dynamic efficiency, the selection of a level to discuss the issue is sometimes arbitrary (see Section 3.2).

The administration of competition policy, based on efficiency considerations, needs to measure and balance the consequences of the different types of efficiency. In the case of technical efficiency, the measurement to-date has focussed on the efficiency aspects of medium and large firms, and small firms efficiencies or inefficiencies become a by-product of this analysis, as when the question is raised as to the extent to which costs rise for plants or firms of less than minimum efficient scale. Technical efficiency needs to be examined for small firms in different types of industries, but especially in the service sector where small firms predominate (see Section 2.3.1).

On the basis of existing studies of different types of scale economies there is not strong support for small firms based on technical efficiency considerations. It is not surprising that the Bolton Report, on small firms in the U.K., came to the conclusion that considerations of dynamic efficiency, related to innovation, provide the most persuasive rationale for the desirability of maintaining a strong small firm sector in the economy. The evidence on this type of efficiency provides the strongest support for small firms (see Section 3.4).

In Canada, concern has been expressed that firms fail to achieve product-specific scale economies. Often this has been related to the problem of product diversification in foreign-owned firms. The development of new information technology,

involving the use of computers and telecommunications, may affect the efficiency of the management and organization of all firms, but especially of firms in the service sector, many of which are small. Information technology will not only affect the competitive position of small firms due to organizational changes, but will provide opportunities for innovation by small firms in terms of hardware and software applications, i.e., there will be implications for dynamic technical and allocative efficiency. Analysis of these issues draws on literature in areas such as office automation, management information systems, and transborder data flows.

Firms which stand to gain by selling new equipment and systems are examining the effects of information systems on the structure and productivity of organizations. Firms such as Xerox Corporation and IBM are involved, along with organizations such as the American Productivity Centre, the National Science Foundation in the U.S., and the Department of Communications in Canada (Straussman, 1980; Resnikoff, 1979).

The emphasis of this research is on the information content of firms. It focusses on the information aspects of transactions, and of the organization of functions and the pool of resources in firms. This is not to suggest that information is something new; it is implicit in the examination of firm economies of scale regarding administrative functions, and in the transaction cost approach to firms and markets. However, because of changes in information technology, the information content of firms will need to be stressed, in addition to

transactions (in the case of Williamson), the administration of a pool of resources (in the case of Penrose, or research and development (in the case of the Bolton Report)(see Sections 3.2.4, 3.2.5 and 3.4).

Information technology may affect the technical efficiency of small firms, as well as the definition of industries and thus the opportunities for innovation by small firms as interstices are opened up in existing industries. The level of impact of new information technology on the competitiveness of firms and industries may be as great as the building of railways and the development of the internal combustion engine were on the costs of transportation. The impact is already taking place and showing, for example, that it is wrong to conclude that there is little room for improving the productivity and efficiency of small firms in the service sector. The traditional Canadian concern with product-specific scale economies may be alleviated by the technology.

17. IT IS RECOMMENDED THAT A STUDY BE MADE OF THE IMPACT OF INFORMATION TECHNOLOGY ON THE EFFICIENCY OF SMALL FIRMS, ESPECIALLY THOSE IN THE SERVICE SECTOR WHERE THE INFORMATION CONTENT OF FIRMS IS HIGH.

Competition policy is administered alongside other government policies, federal, provincial and municipal. Different efficiency aspects of small firms may be affected by the need

for these firms to be cognisant of and to respond to a wide range of government policies. This topic is wider than the impact of regulation on small firms, and includes both detailed regulations, incentives and framework policies, such as taxation and minimum wage laws which affect the competitiveness of small firms.

18. AN EXAMINATION SHOULD BE MADE OF THE IMPACT OF GOVERNMENT POLICIES BESIDES COMPETITION POLICY ON THE EFFICIENCY OF SMALL FIRMS.

The proponents of 'small is beautiful' have invaded peripherally the field of competition policy by questioning whether technology needs to dictate large size due to scale economies in production (Schumacher, 1973). The Antitrust Law and Economics Review is a journal dedicated to promoting the theme that technology exists and could be developed to allow firms in many industries to be efficient at small scales of operation. This 'intermediate' technology would result in small firms and less concentrated industries. An example of this viewpoint can be found in the articles published in the 1980 issue of the Review (Vol. 12, No. 4).

A more persuasive and better documented version of this general theme has been examined in a study which tests the relationship between the organizational size and the performance of firms. Based on Internal Revenue Service data in the U.S.,

it is shown that the rate of earnings on assets declines with increasing organizational size for every size class and industry group (Edmunds, 1979, p. 172).

The issues raised by Edmunds suggest the need to examine the relationship between organizational size and performance as a proxy for efficiency. Methods to achieve greater efficiency in existing organizations overlap with the earlier proposal to examine ways in which information technology can improve corporate productivity. Schumacher's original thesis that 'small is beautiful' rested mainly on the use of intermediate technology in production. More recent work suggests that organizational efficiency may be greater in smaller firms. This study suggests that large firms may experience diseconomies of organizational scale due to difficulties of coordination and communication as identified in the literature of organizational behaviour. Two possible policy options are, first, that large organizations could be disaggregated towards smaller organizations, and second, that measures could be taken to improve the internal efficiency of large organizations (see Section 4.2).

19. IT IS RECOMMENDED THAT A STUDY BE MADE OF THE RELATIONSHIP BETWEEN ORGANIZATIONAL SCALE OF FIRMS AND EARNINGS OF FIRMS, AND COMPARISONS MADE WITH U.S. FINDINGS.

6.4 AREAS FOR FURTHER RESEARCH

The nineteen recommendations for future research are not mutually exclusive and often overlap. One grouping of the recommendations would be as follows:

1. Topic Nos. 1, 9, 14, 15 and 16

An examination of various aspects of the vertical competitive relationship between large and small firms, including the topics of franchising and predatory behaviour.

Hypotheses

The terms of transactions entered into by large firms with small firms increase the scope of large firm influence in markets, and can lead to restrictions on competition. The boundaries of a firm can in effect be expanded as a result of these transactions.

Territorial franchising is a technique to increase the efficiency of distribution, especially in the service sector, without harmful effects on competition.

The dividing line between predatory and competitive behaviour is difficult to distinguish and the welfare effects are unclear. All forms of predatory behaviour should be considered a reviewable trade practice and not made a criminal offence.

2. Topic Nos. 6, 7, 11, 13 and 18

An examination of the attitude of small firms to competition policy as part of the range of government policies affecting small firms.

Hypothesis

The costs to small firms of responding to government intervention discourage small firms from becoming familiar with and taking advantage of government policies including competition policy.

3. Topic Nos. 5 and 8

The causes and consequences of mergers involving small firms.

Hypotheses

The acquisition of small by larger firms is a reflection of dynamic economic forces which allow for management transition as firms grow.

The disappearance of small firms by merger is a result of resource poverty, financial market factors and the operation of government policies.

4. Topic Nos. 10 and 12

An examination of group behaviour on the part of small firms concerning purchasing, manufacturing and exporting.

Hypothesis

Group behaviour by small firms will permit small firms to experience scale economies and transactions cost savings with no harmful effects for competition.

5. Topic Nos. 17 and 19

The impact of information technology and organizational scale on the efficiency and performance of large and small firms.

Hypothesis

Information technology involving computer-communications systems reduces the cost disadvantage of organizing economic activity in small firms. The service sector where many small firms already exist will be especially affected by the technology.

6. Topic No. 2

The competitive impact of trade associations.

Hypothesis

The operation of trade associations tends to undermine the objectives of competition policy by providing channels for collusive communications. These actions offset the advantages gained from trade associations providing better information in markets.

7. Topics No. 3 and 4

An examination of the information collected in the files of the Bureau of Competition Policy and the Foreign Investment Review Agency. This information would be of assistance in researching the six subject areas listed above. In addition the information could be used to test whether the problems faced by small firms in distributive arrangements with larger firms are increasing and why.

It is also recommended that, in the context of these topics, there should be a number of industry case studies undertaken, in order to highlight the competitive aspects of small firms, and

to determine whether there is a need to develop competition policy measures on a case-by-case basis, or whether general policy provisions can be applied.

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APPENDIX A

SMALL BUSINESS DEFINICTIONS: CANADA, THE EEC AND U.S.

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Canada

1. Enterprise Development Program (EDP)

The EDP is a program which provides financial, managerial, and technical aid schemes, with the goal of promoting the competitiveness of Canadian enterprises, especially the technologically innovative firms.

In the area of technological innovation, grants depend on the size of the applicant, and are made as follows:

- up to 50% of eligible costs to applicants whose sales exceeded $10 million in the year immediately preceeding the application
- "up to 75% of eligible costs to applicants whose sales did not exceed $10 million in the year immediately preceeding the application."

2. The Federal Business Development Bank (FBDB)

The FBDB provides numerous services including financial, training, managerial and information. One service which is particularly tailored for small business is called Counselling Assistance to Small Enterprise (CASE), which helps owners and

managers of smaller enterprises improve their management practices. Small in this instance is defined as any proprietorship, partnership, or limited company, in virtually any business, that is located in Canada, and has no more than 75 full-time employees.

3. The Small Business Loans Act

The Small Business Loans administration is designed to assist the credit needs of small business. In this context, a small business is defined as one whose estimated gross revenue does not exceed $2,000,000 during the year in which the application was made. The applicant may be a sole proprietorship, a partnership, or a corporation.

4. Mini-Industrial Research Assistance Program (Mini-IRAP)

The Mini-IRAP makes contributions towards salaries and fringe benefits of professionals and technicians on approved projects. The rationale for this program is to stimulate small companies with limited or no technical staff to solve technical problems through external research and development facilities, and thereafter to encourage such companies to establish their own research and development teams. Eligible applicants must be incorporated Canadian manufacturers.

5. Income Tax Act

Small business is defined in income terms for tax purposes.

Under section 125 of the Canadian Income Tax Act, all Canadian controlled private corporations qualify for a "small business deduction" and pay a lower rate of 25% on the first $150,000 of active business income per year. A firm can claim the "small business deductions" over several years up to a maxumum cumulative total of $750,000. These amounts were increased to $200,000 and $1 million as a result of the 1981 Federal budget.[1]

[1] For a detailed examination of the role of federal government programs in financing small business see An Overview of Small Business Financing, A Report of the Small Business Financing Review Team (Ottawa: Department of Industry, Trade and Commerce, April 5, 1982), pp. 53-68.

The European Economic Community (EEC)

None of the EEC member nations has a legal definition of what constitutes a small or medium-sized enterprise (S.M.E.). The Member States of the European Community employ both qualitative and quantitative criteria when defining the S.M.E. For example, in the Federal Republic of Germany, the commonly held qualitative criteria describes the S.M.E. as one which does not as a rule borrow on the capital markets, is run independently by persons who work on their own account, who are directly involved in the management of the firm, and who bear all the risks.

Another member country, the United Kingdom, in a major government sponsored study, defined the small firm as follows:

> Firstly, in economic terms, a small firm is one that has a relatively small share of its market. Secondly, an essential characteristic of a small firm is that it is managed by its owners or part owners in a personalized way, and not through the medium of a formalized management structure. Thirdly, it is also independent in the sense that it does not form part of a larger enterprise and that the owner-managers should be free from outside control in taking their principal decisions....For practical purposes we are obliged to use a 'statistical definition'...for these statistical and descriptive purposes of our studies (we) adopted the 200 employee upper limit for manufacturing and a series...(of) definitions in terms of whatever measures appeared appropriate for other trades (Bolton, 1972, pp. 1-2).

The Committee used the following quantitative criteria at the time the study was conducted.

Sector	Definition
Industry	up to 200 employees
Building and Construction	up to 25 employees
Mining and Quarrying	up to 25 employees
Retail Trade	Max. Annual Turnover Ь 50,000
Wholesale Trade	Max. Annual Turnover Ь 200,000
Motor Vehicle Trade, Maintenance and Repair	Max. Annual Turnover Ь 100,000
Miscellaneous Services	Max. Annual Turnover Ь 50,000
Road Haulage	Less than 5 vehicles
Hotels, Restaurants, Bars Canteens	All except for firms with several branches and public houses, hotels, etc. controlled by breweries.

When it comes to applying quantitative criteria, sector specific differences are usually taken into account. The German Research Institute for Small and Medium-Sized Enterprises adopted the following classification:

Sector	Employees	Turnover (Millions of DM)
Industry		
- small	up to 50	up to .2
- medium	50 - 499	.2 - 25
Artisanat[1]		
- small	up to 2	up to .1
- medium	3-49	.1 to 2
Wholesaling		
- small	up to 9	up to 1
- medium	10 - 199	1 - 50

[1] Under the 1953 code for the artisanat (revised in 1965), only individuals and companies registered with the Chamber of Trades are authorised to practise as artisans. To be eligible for registration, the head of the enterprise (or manager in the case of a company) must hold a master craftsman's certificate. See the German Artisanat, Commission Working Paper, III/5128/61.

Retailing		
- small	up to 2	up to .5
- medium	3 - 99	.5 to 10
Transport & Communications, Services, Professions		
- small	up to 2	up to .1
- medium	3 - 49	.1 - 2

However, in the case of public policy initiatives designed to promote the competitiveness of the S.M.E., such as qualifying for technical assistance subsidies, the German Government defines the S.M.E. in terms of maximum sales turnover.

Sector	DM(Millions)
Artisanat and Industry	6
Transport Enterprises	2.3
Other Enterprises	1

Just as the member nations have no legal definition of a S.M.E., so the Commission of the European Communities has no official definition of the S.M.E. Nonetheless, the Small and Medium-Sized Enterprises, Artisanat Division, in the Directorate General for Industrial and Technological Affairs,

> which is responsible for examining the problems of these sectors and for their general promotion at Community level, considers, in practice, that enterprises which are legally and financially independent and with no more than 500 employees form part of the above-mentioned sectors (Commission of European Communities, p. 2).

The United States

The U.S. Small Business Administration (SBA), created in 1953 with the mandate "to provide broad assistance to small

businesses", represents one of the most comprehensive, govern-initiated approaches to the problem of defining small business. The Small Business Act (1953) contains the following definition (Public Law 85-536).

> A small business concern shall be deemed to be one which is independently owned and operated and which is not dominant in its field of operation. In addition to the foregoing criteria the Administrator (of the Act), in making a detailed definition, may use those criteria, among others: Number of employees and dollar volume of business. Where the number of employees is used as criteria in making such definition for any of the purposes of this Act, the maximum number of employees which a small business concern may have under the definition shall vary from industry to industry to the extent necessary to reflect differing characteristics of such industries to take proper account of other relevant factors.

One of the full-time functions of the SBA under the Act is to up-date small business size standards for each industry group on a continuous basis. In addition, the agency is responsible for setting eligibility criteria for each SBA program. These vary from program to program to ensure that funds are channelled into needed areas. As with the establishment and constant revision of different size criteria for each industry group, the logic is that changing economic conditions require constant adjustment. Implicit in the SBA's mandate is the viewpoint that absolute size standards are impractical.

Programs administered by the SBA include equity financing, loan assistance, surety bond guarantees and government procurement assistance. Under the latter, the SBA ensures that small firms receive a fair proportion of government purchases

and contracts. Table A-1lists the small business size standards employed by SBA in 1980.

That same year, the SBA's Office of Advocacy released a "business size classification" for researchers interested in studying small business in the United States--projects which might be funded by its Office of Economic Research. One classification of business size is listed in Table A-2. Businesses with 499 or fewer employees are deemed to be small. The Office of Economic Research recognizes that "researchers may find it difficult to obtain data broken out by these size categories" and for this reason recommends that they "should feel free to proceed with the best data available".

Table A-1

SIZE STANDARDS EMPLOYED BY U.S. SMALL BUSINESS ADMINISTRATION

(maximums)

FOR LOANS	ANNUAL RECEIPTS MAXIMUM
Services	*$2-$8 Million
Retail	*$2-$7.5 Million
Wholesale	*$9.5-$22 Million
General Construction	*$9.5 Million
Farming and Related Activities	*$1 Million
	AVERAGE EMPLOYMENT MAXIMUM
Manufacturing	*250 to 1,500
FOR PROCUREMENT	ANNUAL RECEIPTS MAXIMUM
Services	*$2-$9 Million
General Construction	*$12 Million
	AVERAGE EMPLOYMENT MAXIMUM
Manufacturing	*500 to 1,500
FOR SBIC ASSISTANCE	
All Industries	NET WORTH MAXIMUM
	$6 Million
	Average Net Income (after taxes) maximum $2 Million for the preceding two years
FOR SURETY BONDS	ANNUAL RECEIPTS MAXIMUM
All Industries	$3.5 Million

* Varies by industry.

Note: For Loans and for SBIC Assistance, standards increase 25% if a firm operates in an area of high unemployment, as defined by the Labour Department.

Source: SBA, Facts About Small Business and the U.S. Small Business Administration, Washington, February 1981, p. 8.

Table A-2

U.S. SMALL BUSINESS ADMINISTRATION: BUSINESS SIZE DEFINITIONS

SMALL BUSINESS	EMPLOYMENT SIZE	ASSET SIZE	SALES SIZE
Independent Contr.	0	0	Under $100,000
Family Size	1-4	Under $100,000	$100-500,000
Small	5-19	$100-500,000	$500,000-1 million
Medium	20-99	$500,000-5 million	$1-10 million
Large	100-499	$5-25 million	$10-50 million
Total Small Business	0-500	$0-25 million	$0-50 million
MEDIUM BUSINESS	500-999	$25-100 million	$50-250 million
LARGE BUSINESS	1,000+	$100 million+	$250 million+
GOVERNMENT SIZE BUSINESS	10,000+	$2 billion+	$2 billion+

SOURCE: U.S. Small Business Administration (1981).

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